

**TOWARDS CIRCULAR ECONOMY. BASED ON VOLUNTARY STANDARDS  
OF COMPANIES: WHAT TO CHANGE IN LAW TO ENHANCE CIRCULAR  
ECONOMY?**

Master's Thesis

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<p>Tiivistelmä – Referat – Abstract</p> <p>In the last years those companies that pay close attention to transition of their business models to circular economy have adopted good practices to deal with waste prevention and management. High voluntary standards are set and enforced throughout the supply chain.</p> <p>However, good practices and high voluntary standards are taken seriously by the limited number of companies, predominantly, by those who want to be on rider's seat and show example to peers.</p> <p>The recent EU Circular Economy Action Plan, released in March 2020, emphasizes that scaling up the circular economy from front-runners to the mainstream economic players will make a decisive contribution to transition to circular economy that will help to achieve climate neutrality by 2050, decoupling economic growth from resource use, keeping resource consumption within planetary boundaries.</p> <p>The Master Thesis departs from the assumption that there is a need for legal reform in the fields of circular economy law and company law to enhance circular economy for business. It is essential to turn modern policies that are in place into reality on the ground. The project aims to answer the question what legal reforms are necessary and should be prioritized.</p>			
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## LIST OF ABBREVIATIONS

AG	Advocate General
CE	Circular Economy
CEO	Chief Executive Officer
CEPI	Confederation of European Paper Industries
CJEU	Court of Justice of the European Union
CSR	Corporate Social Responsibility
ECtHR	European Court of Human Rights
EMS	Environmental Management System
EU	European Union
GLT	Group Leadership Team
GRI	Global Reporting Initiative
ICC	International Chamber of Commerce
KPI	Key Performance Indicators
MS	Member State
SCoC	Supplier Code of Conduct
SDG	Sustainable Development Goal
SME	Small and Medium-Sized Enterprise
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
WBCSD	World Business Council for Sustainable Development
WFD	Waste Framework Directive
WPP	Waste Prevention Programme
UN	United Nations

## LIST OF DEFINITIONS

**2030 Agenda for Sustainable Development** - agenda adopted in 2015 at an UN summit to eradicate poverty and achieve sustainable development by 2030 world-wide, includes 17 SDGs.

**Articles of Association** - document in which the core corporate governance issues of the company are defined, including purpose and shareholders' and managers' rights and obligations.

**Circular Economy** - type of economy aimed at eliminating waste and unlimited use of resources, prolonging the lifecycles of the products through reuse, recycling, recovery, repairing and etc.

**Confederation of European Paper Industries** is the association representing the forest fiber and paper industry in Europe.

**Company** - in the context of this work means a profit-making legal entity formed by shareholders (private sector business alike two companies studied in chapter three of the thesis).<sup>1</sup>

**Corporate Social Responsibility** - model of self-regulating for business that helps a company be socially accountable.

**Domicile** - place of company's residence, the one it has a substantial connection with.

**Ellen MacArthur Foundation** - organization aimed at contributing to better future through the framework of a circular economy.

**Global Reporting Initiative** - an independent international organization that has adopted global standards for sustainability reporting.

**Greenwashing** - disinformation disseminated so as to present an environmentally responsible public image.

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<sup>1</sup> For instance, cooperatives are not covered here, although cooperatives and companies share many normative and functional similarities and may operate in similar business sectors. To discover the possibilities of the cooperative business model as a driver for sustainable change see Pönkä, Ville: The Cooperative as a Platform for Sustainable Business Operations in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 48, p. 682-695.

**Linear Economy** type of economy in which production and resources are considered to be unlimited and economic benefits are preferred, also referred as traditional “take-make-consume-waste” model.

**Nasdaq Helsinki** - stock exchange located in Helsinki.

**Nasdaq Stockholm** - stock exchange located in Stockholm.

**Planetary Boundaries** - the framework based on scientific evidence that human actions are the main driver of global environmental change.

**Sustainable Development** is a broad concept intended to strike a balance between the need for economic growth and environmental protection, social equity.

**Sustainable Development Goals** - collection of 17 interdependent goals for more sustainable future aimed to be achieved by 2030, set in 2015 by the United Nations General Assembly.

**SDG Compass** - developed by GRI, the UN Global Compact and the WBCSD, provides guidance for companies on how they can align their strategies as well as measure and manage their contribution to the realization of the SDGs.

**SDG-washing** - disinformation disseminated so as to present a SDG -responsible public image.

**SMART project** - research project of the team of Sustainable Market Actors for Responsible Trade within the EU’s Horizon 2020 research and innovation programme.

**Voluntary Standards** - in the context of this work those goals companies set above mere compliance with regulation, elements of volunteerism.

**UN Global Compact** is a non-binding UN principle-based framework for businesses encouraging businesses worldwide to adopt sustainable and socially responsible policies, and to report on their implementation.

**World Business Council for Sustainable Development** is a global CEO-led organization connecting more than 200 companies from different business sectors co-working on accelerating transition to a sustainable world.

## 1. INTRODUCTION

### 1.1. The State of the Art

The well-known postulate of the Brundtland Report that we must redesign the way we live so that we meet our needs today without compromising the ability of future generations to meet theirs<sup>2</sup> remains as actual as ever. Today resource extraction and processing outcomes in half of total greenhouse emission, more than 90% of biodiversity loss and water stress.<sup>3</sup> This statistics is oppressive and alarming. Urgent action is needed to increase recycling and “circular economy” approaches to reduce environmental pressure and impact.<sup>4</sup>

It goes without saying that “take-make-consume-waste” approach of traditional linear economy is not an option anymore. It is circular economy that encapsulates many sustainability trends, including carbon neutrality, resource efficiency and industrial ecology, functioning as an overall framework for the global transition to sustainability.<sup>5</sup> Failure to shift to circular economy in a due time may cause severe societal and ecological breakdown that would threaten the human wellbeing in future.

The circular economy refers to a regenerative and restorative economic system that aims to optimize resource usage and reduce waste, and offers potential to innovate novel value creation opportunities for business.<sup>6</sup> The role of the latter in the transition to sustainability-driven circular economy is crucial.

In the last years those companies<sup>7</sup> that pay close attention to transition of their business models to circular economy have adopted good practices to deal with waste prevention and management. High voluntary standards are set and enforced throughout the supply chain. However, good practices and high voluntary standards are taken seriously by the limited number of companies, predominantly, by those who want to be on rider’s seat and show example to peers. There are front-runners and free-riders and no level playing field exists regarding circular

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<sup>2</sup> World Commission on Environment and Development, Our Common Future (Oxford University, 1987), commonly referred to as the Brundtland Report.

<sup>3</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions “A new Circular Economy Action Plan For a cleaner and more competitive Europe”, COM/2020/98 final, Brussels, 11.3.2020 (EU Circular Economy Action Plan 2020), p.2. Available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1583933814386&uri=COM:2020:98:FIN> (Accessed 3d June 2020).

<sup>4</sup> United Nations Sustainable Development Goals Report 2020, p.50. Available at <https://unstats.un.org/sdgs/report/2020/The-Sustainable-Development-Goals-Report-2020.pdf> (Accessed 16th July 2020).

<sup>5</sup> Rantaa, Valtteri - Keranen, Joona - Aarikka-Stenroos, Leena: How B2B suppliers articulate customer value propositions in the circular economy: Four innovation-driven value creation logics, Industrial Marketing Management, Vol. 87, May 2020, p.1.

<sup>6</sup> Ibid.

<sup>7</sup> As defined in the List of Definitions.



economy standards. This might play a really devastating role and make companies that set high voluntary standards but have to compete with others who do not to “race to the bottom”.

The recent EU Circular Economy Action Plan, released in March 2020, emphasizes that scaling up the circular economy from front-runners to the mainstream economic players will make a decisive contribution to transition to circular economy that will help to achieve climate neutrality by 2050, decoupling economic growth from resource use, keeping resource consumption within planetary boundaries.<sup>8</sup>

It is essential, however, to turn recent highly ambitious policies into reality on the ground. The Master Thesis departs from the assumption that there is a need for legal reform in the fields of circular economy law and company law to enhance circular economy for business. The study aims to answer the question: what legal reforms are necessary and should be prioritized.

To answer the question it is indispensable to look at two traditional ways of addressing circular economy agenda by companies: compliance with circular economy law and voluntary set higher circular economy standards. The thesis is aimed at assessing whether these two traditional forms of approach towards transition to circular economy are only and solely enough and whether the role of company law is underestimated. Therefore, the thesis examines all three elements (circular economy law, voluntary circular economy standards and company law) simultaneously and in relationship with each other with the reference to the relevant legal framework and academic studies.

The main lever when one is to address transition of business to circular economy and its waste prevention, management focus is the EU Waste Framework Directive (hereinafter Waste Framework Directive, WFD).<sup>9</sup> The Directive is implemented by Member States and together with the latter’s legislation at question constitutes the basic legal framework for business to operate within. Therefore, being simultaneously a major binding and guiding tool the Directive and the following Member States’ implementation instruments are to be highly harmonized and easy to interpret and implement to further facilitate the use of recovered material.<sup>10</sup>

The way rules on waste are implemented and enforced has important consequences on waste management choices, such as feasibility and economic viability of collection, recycling

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<sup>8</sup> EU Circular Economy Action Plan 2020, p.2.

<sup>9</sup> Directive 2008/98/EC of the European Parliament and of the Council of 19 November 2008 on waste and repealing certain Directives (OJ L 312, 22.11.2008, p. 3).

<sup>10</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Implementation of the Circular Economy Package: Options to Address the Interference Between Chemical, Product and Waste Legislation, COM (2018) 32 final, Strasbourg, 16.1.2018, p.5.

method or the choice between recycling and disposal.<sup>11</sup> However, recent studies on the EU level show that the more harmonized interpretation and implementation of end-of-waste rules across the EU must be enabled to further facilitate the use of recovered material.<sup>12</sup> This thesis has a goal to examine the usefulness and effectiveness of WFD's cornerstone concepts that are of the highest interest for circular-oriented business and reapprove that they are not the best option to enhance circular economy.

It is also important to make more visible for the front-runner companies the fact that in a situation of still developing and far from ideally harmonized circular economy law, their volunteerism in setting higher circular economy standards also has certain obvious limitations and can't overcome alone the problem of level playing field absence. There is a need for companies to realize that the goal to enhance circular economy should be approached through the instruments of company law and, therefore, it is company law reform that should be prioritized.

In this regard two front-runner companies from forest sector<sup>13</sup> in which the issues of waste prevention and management are one of the dominant were taken to enrich this research with a case study. This case study helped to provide a link between two different legal fields that companies comply with: circular economy law and company law and to show correlation of voluntary set standards with core circular economy law concepts.

## **1.2. Theoretical background**

As long as the main idea of the thesis is to emphasize the role of company law it is important to consider the ongoing debate of scholars whether or not company law can be used as an instrument to tackle such societal problems as sustainability and circularity.

The mainstream company law theory presented in the highly influential book by Kraakman et al., *The Anatomy of Corporate Law* sets out a broad goal for corporate law to advance the aggregate welfare of all who are affected by a firm's activities, including the firm's shareholders, employees, suppliers, and customers, as well as third parties such as local

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<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

<sup>13</sup> The choice of two companies (UPM and Stora Enso) was made due to the participation in the HELSUS (Helsinki Institute of Sustainable Science) Co-Creation Circular Economy Lab – project within the University of Helsinki for the students from multiple disciplines to cooperate in their research dedicated to circular economy. Within the concept of the project all the Master Thesis students were separated in four groups, where they had an opportunity to conduct research with the Partners – representatives of industry and the Finnish Ministry of Environment. This Master Thesis has been written within the Forest Group with Partner Company – UPM Kymmene.

communities and beneficiaries of the natural environment.<sup>14</sup> However, in B. Sjøfjell's view, Kraakman et al. remain skeptical to what they see as a 'recent trend toward employing the legal strategies of corporate law to tackle broad social problems'.<sup>15</sup>

In general, the fundamental profit-orientation of corporation is undoubtedly undisputable, but as F. Möslin fairly points out today "the more precise definition of corporate purpose is intensively debated both among economists and lawyers".<sup>16</sup>

There is a large group of company law scholars who share the view that putting company law on a normative foundation of sustainability is a major reform goal of nowadays and there is pressing need to reform mainstream corporate governance for all companies, not just a self-selected few.<sup>17</sup> It is also emphasized, that promoting sustainability cannot be left solely to corporate volunteerism, but also requires enabling legal frameworks that go beyond conventional environmental regulation to ensconce within company law the necessary standards and procedures.<sup>18</sup> Scholars with "strong sustainability approach" rely on concept of "planetary boundaries"<sup>19</sup> to redefine the purpose of corporation and the role and duties of the board of directors.<sup>20</sup>

The author of this thesis believes that company law as a private discipline largely affecting companies' operation can't stay aside in the process of transition to sustainability and

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<sup>14</sup> Sjøfjell, Beate: Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking in Preventing Environmental Damage from Products: An Analysis of the Policy and Regulatory Framework in Europe, Eléonore Maitre-Ekern, Carl Dalhammar and Hans Christian Bugge (eds.), Cambridge University Press 2018, Chapter 5, p.108.

<sup>15</sup> Ibid, p.110.

<sup>16</sup> Möslin, Florian: Certifying "Good" Companies. A comparative study of regulatory design in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 47, p. 669. Möslin invites to see, for instance, O. Hart and L. Zingales: Companies Should Maximize Shareholder Welfare Not Market Value (2017) 2 Journal of Law, Finance and Accounting, 247; M. Blair and L. Stout: A Team Production Theory of Corporate Law (1999) 85 Virginia Law Review, 247; B. Sjøfjell: Dismantling the Legal Myth of Shareholder Primacy: The Corporation as a Sustainable Market Actor, in N. Boeger and C. Villiers (eds.), Shaping the Corporate Landscape (Oxford: Hart Publishing, 2018), p. 77.

<sup>17</sup> Bruner, Christopher M. - Sjøfjell, Beate: Corporate Law, Corporate Governance and the Pursuit of Sustainability in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 50, p.718. See also: J. Mähönen and G. Johnsen: Law, Culture and Sustainability: Corporate Governance in the Nordic Countries, Ch. 16; B. Sjøfjell, J. Mähönen, A. Johnston and J. Cullen: Obstacles to Sustainable Global Business. Towards EU Policy Coherence for Sustainable Development, University of Oslo Faculty of Law Research Paper No. 2019-02, <https://ssrn.com/abstract=3354401>; Beate Sjøfjell: Realising the Potential of the Board for Corporate Sustainability. Ch. 49.; Dionysia Katelouzou: Shareholder Stewardship. A case of (Re) Embedding the Institutional Investors and the Corporation. Ch. 41, etc.

<sup>18</sup> Richardson, Benjamin J. - Sjøfjell, Beate: Capitalism, the Sustainability Crisis, and the Limitations of Current Business Governance in Company Law and Sustainability: Legal Barriers and Opportunities, Beate Sjøfjell and Benjamin J. Richardson (eds.), Cambridge University Press, 2015, p. 1.

<sup>19</sup> Raworth, Kate: A safe and just space for humanity. Can we live within the doughnut? Oxfam discussion Paper, Oxfam International, February 2012, pp.12-18.

<sup>20</sup> Katelouzou, Dionysia: Shareholder Stewardship. A case of (Re) Embedding the Institutional Investors and the Corporation? in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 41, p.590.

circular economy. The author has a goal to contribute to the field of the related scholarship by case study of two companies – representatives of forest sector – highly conscious about circularity, combined with comparative research of several jurisdictions, assessing all three possible approaches of companies towards circular economy (through circular economy law, voluntary standards and company law) and their interconnection, and with the aim to re-approve that level playing field can't be achieved if companies do not consider the role of company law seriously.

### **1.3. Research Question**

The purpose of this thesis is formulated in the research question as follows: based on the higher and voluntary sustainability standards of two companies (namely, UPM and Stora Enso),<sup>21</sup> what should circular economy law and company law at national (Finland, Germany) and EU levels change to enhance circular economy?

The main idea of the thesis, inspired by the willingness to potentially “scale up the circular economy from front-runners to the mainstream economic players”,<sup>22</sup> therefore, is to evaluate whether voluntary circular economy standards set by companies and compliance with circular economy law without shaping company law are enough to ensure sustainable shift of business to circular economy.

### **1.4. Hypothesis**

The hypothesis of the study can be stated this way: 1) both: circular economy and company law might need to be reformed to enhance circular economy; 2) higher and voluntary set sustainability standards of front-runner companies and compliance with circular economy law might not be enough to enhance circular economy; 3) company law reform might have a predominant role to enhance circular economy for companies.

### **1.5. Methodology**

To answer the research question voluntary set standards of two companies: UPM and Stora Enso were examined and analyzed, those related to circular economy and with waste

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<sup>21</sup> See citation 11 above.

<sup>22</sup> EU Circular Economy Action Plan 2020, p. 2.

prevention, management focus. Recent circular economy and company laws (EU, German, Finland) with the same focus were overviewed and analyzed to find out to what extent law compliments, supports and ensures companies' volunteerism and contributes to establishment of level playing field, what are the major stumbling blocks to overcome.

Legal framework of this thesis lies in the legal sources of the EU, Finland and Germany, related to circular economy and company law. It is worth mentioning that the work is aimed at analyzing core concepts of the EU Waste Framework Directive connected with circular economy and waste prevention, management focus in particular, such as waste, disposal, end-of-waste status, waste hierarchy, precautionary principle and waste plans of member states. The latter are then discussed with the reference to German and Finnish legal acts implementing the Directive. Regarding company law the analysis is limited to the purpose of company and duties of board as they are presented on the EU, German and Finnish levels.

The study is addressing the most recent disclosure documents of the examined companies: Annual Reports 2019, updated in 2019 Codes of Conduct and Third Party/Suppliers Codes. EU Circular Economy Action plan 2020 is cited and 2020 Corporate Governance Codes of Finland and Germany are presented.

Taking into consideration the industrial specialization of two companies at question (forest sector) and the way they address circular economy challenge the focus for the research was concentrated on the waste prevention and management aspects closely connected to recycling and dealing with secondary raw materials as a precondition of circular economy. The waste prevention, management focus was applied both while examining companies voluntary standards and circular economy law.

The choice of jurisdictions: EU and two Member States: Finland and Germany was due to several reasons. Firstly, it was indispensable to address EU policies and cornerstone legal acts as they undoubtedly set the ambition and provide guidelines, as well as create binding legal norms for the whole Union and its Member States. Finland is the state where two examined companies are domiciled and the research is conducted. Moreover, the Finnish firms see themselves as forerunners of sustainable, circular economy.<sup>23</sup> Germany was chosen because both companies have assets and operate in this jurisdiction and as a ground for comparative study of both: two Member States implementing Waste Framework Directive regarding Waste Plans and company law correlation with sustainability agenda.

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<sup>23</sup> Näyhä, Annukka: Transition in the Finnish forest-based sector: Company perspectives on the bioeconomy, circular economy and sustainability, *Journal of Cleaner Production*, February 2019, Volume 209, pp. 1294-1306.

Decision to address recent Court of Justice of the European Union (CJEU) case law was underpinned by the EU mechanism of directives implementation and interpretation role of the Court. While study of German and Finnish case law regarding implementation of Waste Framework Directive core concepts (waste, disposal, end-of-waste status, precautionary principle) was not feasible within the master thesis and certainly needs separate research, the examining of CJEU cases gave an opportunity to reveal the major problems Member States face through concepts implementation.

The study aims to be analytical and evaluative. The primary method used for conducting the research is the method of legal dogmatics. The norms of different legal acts applicable to the topic are identified, grouped within the chapter's tasks and analyzed.

A critique and suggestive (corrective) approach and evaluation as to practical application of legal norms or policy issues will be observed.

Voluntary circular economy standards of two companies will be analyzed empirically based on public information.

Comparison method will be applied with regard to Germany and Finland legal norms evaluation. The process of comparison will be structured as follows: 1) what is to compare and why; 2) what classification categories should be employed; 3) how the problem of data language should be solved.<sup>24</sup> In this regard two EU Member States' Waste Plans will be examined with a view to depict the role governments devote to business in waste prevention. The comparison category will be the type of policy: command or advice. The sustainability dimension of Finnish and German company laws will be examined to assess to what extent sustainability is presented. The comparison category will be the basics of company law: purpose of company and duties of board. In all the cases when comparison method will be applied the data language aspect will be limited to the use of the material available in English.

## **1.6. Structure**

The thesis is presented as an introduction, four chapters and conclusion. Each chapter deals with a certain task of the research.

In the *second chapter* waste prevention and management focus will be maintained. The major EU policy making documents: EU Circular Economy Action Plan 2015 and Monitoring Framework will be addressed to depict the importance of shift to circular economy and the role

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<sup>24</sup> Samuel, Geoffrey: Does one need an understanding of methodology in law before one can understand methodology in comparative law? in Methodologies of Legal Research. Which Kind of Method for what kind of discipline? Mark Van Hoecke (ed.), Oxford, Portland, Or.: Hart, 2011, p.182.

of business in it. Then we will turn to the main lever for the mentioned policies – EU Waste Framework Directive and its obligation towards Member States to develop and monitor Waste Prevention Plans. German and Finnish Waste Prevention Plan's general issues and the role they give to the business will be examined. The aim is to find out whether Member States at question guide and command precisely the business how to arrange waste prevention and management with the binding regulation instruments, applying top-down approach, or more soft, bottom-up techniques are prevailing, those more relying on companies volunteerism.

Then the core concepts of the WFD: waste, disposal, end-of-waste status, precautionary principle will be examined through the prism of the CJEU interpretation available in the recent cases. It will give an opportunity to analyze the level of harmonization regarding interpretation of these concepts on the EU level and the size of Member States' margin of discretion regarding waste hierarchy and certain rules devoted to establishment of end-of-waste status. The assessment of level of harmonization of interpretation and implementation of end-of-waste rules will give a picture to what extent circular economy law in the recent state-of-the-arts is able to facilitate the use of recovered material and help business to enhance circular economy. The general purpose of the chapter is to reveal whether circular economy law is an efficient and enough tool for companies to rely on while making a shift towards circular economy.

The purpose of the *third chapter* is to examine voluntary standards of two companies UPM and Stora Enso towards shift to circular economy and its waste prevention and management dimension. The aim is to present three voluntary standards for each company. In the context of this work term *voluntary standards* is used to address the substance of voluntary standards set in the disclosure papers of companies, including the voluntary mechanism of their assurance throughout the supply chain. That means that the process and results of real life enforcement of these voluntary standards are omitted from this research, as it deserves to be the topic of a separate research investigation and discussion.

The third chapter is aimed at analyzing how high is the ambition of the companies, how much attention companies pay to circular economy agenda and its waste prevention, management dimension in particular, how high standards are formulated and what is their basic logic. It is beneficial to find out whether companies vision differs much or follows the same logic and what do companies rely on while setting higher goals. The possible downsides of the volunteerism and obstacles they constitute regarding enhancing circular economy will be presented and discussed in the third chapter – those most probably to overcome with the help of binding power of law.

In the *fourth chapter* company law will be analyzed (cornerstone issues: purpose of companies and duties of board on the levels of EU, Germany and Finland) to discover its

correlation with sustainability. The aim is to find out whether company law promotes, denies sustainability or stays neutral.

In the *fifth chapter* the major role of company law for business aimed to shift to circular economy will be emphasized and the changes the company law needs to go through to be put on a normative foundation of sustainability will be discussed. The role of strong shareholder primacy social norm will be presented and discussed especially with the focus of its specific effect: externalization of environmental and circular economy agenda from the core decision-making in companies. In an illustrative manner the reform proposals of SMART project will be presented.

*Conclusion chapter* will summarize the essentials of the research results, following the logic of the chapters mentioned above. The answer to the research question will be formulated and discussed. Possible further directions of the research on the topic will be suggested.

## **2. CIRCULAR ECONOMY LAW**

In this chapter we are to define whether and to what extent circular economy law can assist business in its demand to be more circular. What are the major stumbling blocks to rely on the sectoral law while making a sustainable shift to circular economy? We will look into circular economy law framework, with the waste management focus that will also be employed in the next chapter, starting from the basic policy setting documents on the EU level: EU Circular Economy Action Plan 2015,<sup>25</sup> EU Monitoring Framework for the CE. We then will pay attention to one of those policies' levers - Waste Framework Directive.

When looking at the WFD and its implementation on the Member States level we will concentrate on 3 basic elements: waste plans, end-of-waste-status, precautionary principle. We will study relevant to circular economy aspects of Waste Plans of Germany and Finland (under art. 29 WFD) and how they address the waste management measures to business. In this respect it is worth discovering whether Waste Plans set clear and precise goals, give concrete plan for business action and apply top-down approach or follow bottom-up, advice-based tactics.

While looking at the end-of-waste-status and precautionary principle we will study the recent CJEU case law on the matter. It will give an opportunity to find out what practical

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<sup>25</sup> In March 2020 a new EU Circular Economy Action Plan was released. This thesis is concentrating on the previous plan taking in regard that the latter had been already implemented (the results are reported), correlates with the development of Waste Plans on the Member States level and the CJEU case law, and can be analyzed in a more comprehensive manner, than the new one which is a collection of policies goals and statements that would be further developed on the EU level, but yet there has not been much data surrounding it to be analyzed in the context of this research.



problems business might face when trying to adopt those rules that were set on the EU level and then implemented on Member States level. We will concentrate at finding answers to the following questions: How helpful are basic waste prevention and management concepts for adopting product life cycle thinking in companies?

## **2.1. Circular Economy: EU Action Plan 2015 and Monitoring Framework. Waste Focus**

The contribution of recycled materials to overall materials demand is relatively low. Trade in secondary raw materials is increasing both in the EU and with third countries. In a circular economy, materials embedded in products and components are recycled when they reach their end-of-life and are then injected back into the economy as secondary raw materials.<sup>26</sup> This reduces the environmental footprint of production and consumption and increases the security of supply of raw materials. In the EU, the level of demand for raw materials exceeds what could be supplied even if all waste were turned into secondary raw materials. On average, recycled materials only satisfy around 10 % of the EU demand for materials, in spite of a steady improvement since 2004.<sup>27</sup> Much is to be enhanced in this respect.

In December 2015 the European Commission adopted a Circular Economy Action Plan “to give a new boost to jobs, growth and investment to develop a carbon neutral, resource-efficient and competitive economy”.<sup>28</sup> In the Plan, a circular economy is explained as an economy “where the value of products, materials and resources is maintained in the economy for as long as possible, and the generation of waste minimized”.<sup>29</sup> The Plan establishes a concrete programme of actions outlining measures that cover the entire product life cycle: from production and consumption to waste management and the market for secondary raw materials. On 4 March 2019, the European Commission adopted a comprehensive report on the implementation of the Circular Economy Action Plan.<sup>30</sup>

It is a general assumption that circular economy is instrumental in supporting the EU’s commitments on sustainability and in particular to reach Sustainable Development Goal 12

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<sup>26</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a monitoring framework for the circular economy, COM(2018) 29 final, Strasbourg, 16.1.2018, p.8. Available at <https://ec.europa.eu/environment/circular-economy/pdf/monitoring-framework.pdf> (Accessed 1st July 2020).

<sup>27</sup> Ibid.

<sup>28</sup> Final Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the implementation of the Circular Economy Action Plan, COM(2019) 190 final, Brussels, 4.3.2019, p.1. Available at [https://ec.europa.eu/commission/sites/beta-political/files/report\\_implementation\\_circular\\_economy\\_action\\_plan.pdf](https://ec.europa.eu/commission/sites/beta-political/files/report_implementation_circular_economy_action_plan.pdf) (Accessed 1st July 2020).

<sup>29</sup> COM(2018) 29 final, p.1.

<sup>30</sup> COM(2019) 190 final, p.1.

‘Responsible consumption and production’.<sup>31</sup> Action on the circular economy ties in closely with key EU policy priorities and with global efforts on sustainable development.<sup>32</sup> Sound and efficient waste management systems are an essential building block of a circular economy. It is important to modernise waste management systems in the Union and to consolidate the European model as one of the most effective in the world.<sup>33</sup>

It is emphasized that should the EU want to maintain its leadership in designing and producing circular products and services and in better empowering consumers to adopt more sustainable lifestyles, new actions would be needed.<sup>34</sup> In particular, businesses will need to step up their efforts to implement the revised waste legislation and develop markets for secondary raw materials. The objective is to ensure that materials going back into the economy are cost-efficient and safe for citizens and the environment.<sup>35</sup>

As stated in the strategic long-term vision for a prosperous, modern, competitive and climate-neutral economy by 2050, the transition towards a circular economy and a climate-neutral economy should be pursued together, based on a strong industrial ambition and reaping the EU businesses’ first-mover advantage in these areas.<sup>36</sup> New circular business models, recycling, energy and material efficiency and new consumption patterns have a significant potential to reduce unsustainable extraction of non-renewable raw material and, additionally, cut global greenhouse gas emissions. Promoting this joint approach in companies – including SMEs – and communities can at the same time reduce production costs and support new forms of business interaction such as industrial symbiosis.<sup>37</sup>

More to that, circularity and sustainability in the sourcing, use and treatment of raw materials (in particular critical ones) will be key to ensure the necessary security of supplies, a level playing field with industrial competitors and the EU’s global leadership in the production of key enabling and low-carbon technologies.<sup>38</sup> This will in turn not only cut waste, it will also reduce the need for new resources to be extracted at great financial and environmental cost.<sup>39</sup>

Undoubtedly, the transition to a circular economy, including to a circular bioeconomy, is a huge opportunity to create competitive advantages on a sustainable basis.<sup>40</sup> It seems to be

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<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid, p.4.

<sup>34</sup> Ibid, p.10.

<sup>35</sup> Ibid, p.10.

<sup>36</sup> Ibid, p.11.

<sup>37</sup> Ibid, p.11.

<sup>38</sup> Ibid, p.11.

<sup>39</sup> European Commission Reflection Paper Towards a Sustainable Europe by 2030 COM (2019) 22 pp.17-18. Available at [https://ec.europa.eu/commission/sites/beta-political/files/rp\\_sustainable\\_europe\\_30-01\\_en\\_web.pdf](https://ec.europa.eu/commission/sites/beta-political/files/rp_sustainable_europe_30-01_en_web.pdf) (Accessed 1st July 2020).

<sup>40</sup> Ibid.

very simple: what was previously considered waste can be used again for making new products.<sup>41</sup>

Thus, the high and promising goals are set, encouraging policies are developed but it is also essential to turn those policies that are in place into reality on the ground, and continue to prioritise new actions at all levels of the EU governance. For instance, the ambitious modernisation of the EU rules on waste are to be put in practice by Member States. Lifecycle assessments of products should become a norm and the eco-design framework – created for increasing the efficiency of products to reduce energy and resource consumption – should be broadened as much as possible.<sup>42</sup> How to ensure that?

In 2018 the Commission presented The EU Monitoring Framework for the Circular Economy that includes 10 key indicators covering each phase of the lifecycle of products as well as competitiveness aspects.<sup>43</sup> It shows that circularity has opened up new business opportunities, given rise to new business models and developed new markets, domestically and outside the EU.<sup>44</sup>

The framework describes the transition to a circular economy as a tremendous opportunity to transform economy and make it more sustainable, contribute to climate goals and the preservation of the world's resources, create local jobs and generate competitive advantages for Europe in a world that is undergoing profound changes. It is reassured that, the transition to a circular economy will also help to meet the objectives of the 2030 Agenda for Sustainable Development.<sup>45</sup>

In the transition to a more circular economy, monitoring the key trends and patterns is key to understand how the various elements of the circular economy are developing over time, to help identify success factors in Member States and to assess whether sufficient action has been taken.<sup>46</sup> The results of monitoring should form the basis for setting new priorities towards the long-term objective of a circular economy. They are not just relevant to policy makers, but should inspire all and drive new actions.<sup>47</sup> This has been echoed by the Council of the EU, in its conclusions on the Circular Economy Action Plan, where it stressed “the need for a monitoring framework to strengthen and assess the progress towards circular economy, while minimising the administrative burden”.<sup>48</sup>

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<sup>41</sup> Ibid.

<sup>42</sup> Ibid.

<sup>43</sup> COM(2019) 190 final, p.1.

<sup>44</sup> Ibid.

<sup>45</sup> Ibid.

<sup>46</sup> Ibid.

<sup>47</sup> Ibid.

<sup>48</sup> Ibid.

The monitoring framework aims at measuring progress towards a circular economy in a way that encompasses its various dimensions at all stages of the lifecycle of resources, products and services. This is why the monitoring framework has a set of ten indicators grouped into four stages and aspects of the circular economy: (1) production and consumption, (2) waste management, (3) secondary raw materials and (4) competitiveness and innovation. This broadly follows the logic and structure of the Circular Economy Action Plan.<sup>49</sup>

Within 10 indicators set within the framework, three indicators of transition to circular economy represent most interest in the context of this research, being relevant to Waste: 3a-c “waste generation is minimized”, 5a-b “increasing recycling”, 7a-b “secondary raw materials are commonly used to make new products”. Those three are connected to the lever Waste Framework Directive.

## **2.2. Waste Framework Directive: Waste Plans. Germany and Finland**

### **2.2.1. Waste Framework Directive Overview. Waste Hierarchy and Members States’ Waste Prevention Measures**

Under article 1 of the WFD, the latter lays down measures to protect the environment and human health by preventing or reducing the generation of waste, the adverse impacts of the generation and management of waste and by reducing overall impacts of resource use and improving the efficiency of such use, which are crucial for the transition to a circular economy and for guaranteeing the Union’s long-term competitiveness.<sup>50</sup>

Within the recitals 6, 8, 28, and 31 the core goals of the WFD are stated as follows:

- minimising the negative effects of the generation and management of waste on human health and the environment; reducing the use of resources, favouring the practical application of the waste hierarchy;<sup>51</sup>
- strengthening the economic value of waste; encouraging the recovery of waste and the use of recovered materials;<sup>52</sup>
- moving the EU closer to a “recycling society”, avoiding waste generation and using waste as a resource;<sup>53</sup>

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<sup>49</sup> Ibid, p.2.

<sup>50</sup> Waste Framework Directive, art.1.

<sup>51</sup> Ibid, recital 6.

<sup>52</sup> Ibid, recital 8.

<sup>53</sup> Ibid, recital 28.

- departing from waste hierarchy for specific waste streams when justified for reasons of, inter alia, technical feasibility, economic viability and environmental protection.<sup>54</sup>

Waste Framework Directive reaffirmed waste prevention as the top priority of waste management. The introduction of a further level of the waste hierarchy has also strengthened the preparation for reuse as a second priority after prevention. However, within the implementation process on the Member States level, the latter have a margin of discretion being not obliged to opt for a specific prevention and management option.

In the recent 2019 case the CJEU presented its interpretation regarding “balance test” for waste hierarchy principle and Member States measures of waste prevention and management.<sup>55</sup> The Court noted that Article 4(1) of the WFD provides that ‘the ... waste hierarchy shall apply as a priority order in waste prevention and management legislation and policy: (a) prevention; (b) preparing for re-use; (c) recycling; (d) other recovery, e.g. energy recovery; and (e) disposal’.<sup>56</sup>

Under the CJEU interpretation, the waste hierarchy amounts to an objective, which leaves a margin of discretion to the Member States by not obliging them to opt for a specific prevention and management option.<sup>57</sup> Therefore, under Article 4(2) of the WFD, when implementing the ‘waste hierarchy’ principle, Member States take measures to encourage the options that deliver the best overall environmental outcome. The latter includes departing from the hierarchy where this is justified by life-cycle thinking on the overall impacts of the generation and management of such waste.<sup>58</sup> Moreover, according to Article 13 of the WFD, Member States take the necessary measures to ensure that waste management is carried out without endangering human health and without harming the environment, in particular without risk to water, air, soil, plants or animals.<sup>59</sup>

To sum it up, while it is for the Member States to choose the most appropriate means of complying with the ‘waste hierarchy’ principle, they must, however, comply with the other provisions of the WFD which lay down more specific obligations.<sup>60</sup> All in all, Member States have a margin of discretion being not obliged to opt for a specific prevention and management option which may affect the level of harmonization of the WFD rules at question and bring differences in implementation policies throughout the EU. In the context of business shifting to

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<sup>54</sup> Ibid, recital 31.

<sup>55</sup> Case C-305/18 Associazione "Verdi Ambiente e Società - Aps Onlus" and Others (Sixth Chamber, 8 May 2019) ECLI:EU:C:2019:384, para.9.

<sup>56</sup> Ibid para.27.

<sup>57</sup> Ibid para.29.

<sup>58</sup> Ibid para.30.

<sup>59</sup> Ibid para.31.

<sup>60</sup> Ibid para.38.

circular economy this might mean that waste hierarchy principle implemented differently in Member States may affect the way waste-related business issues are tackled by companies that have assets in several Member States: the unified approach seems unlikely.

As it was illustrated above the waste hierarchy of the WFD reaffirmed waste prevention as the top priority of waste management. In order to support the Member States in their efforts to prevent waste, Article 29 WFD provides for the development of national waste prevention programmes in which both existing measures as well as future fields of action for waste prevention are to be described.<sup>61</sup>

It is worth looking at concrete examples (Germany and Finland), presenting what role is devoted to business in those plans.

### **2.2.2. Waste Framework Directive Implementation. Germany and Finland**

The WFD has been transposed into German law in form of the Life-Cycle Management Act (Kreislaufwirtschaftsgesetz – KrWG)<sup>62</sup>. In Finland the WFD has been transported into Finnish law in form of Waste Act (Jätelaki).<sup>63</sup>

Both Germany and Finland, as well as all EU members according to Article 29 of the WFD, are obliged to develop national waste prevention programmes and have the option of specifying suitable waste prevention indicators or benchmarks.<sup>64</sup> Waste prevention programmes should include objectives and measures to decouple economic growth from the environmental impacts of waste generation. In order to monitor and evaluate the progress of these waste prevention measures, Member States should lay down appropriate and specific standards. These standards can either be of qualitative or quantitative nature.<sup>65</sup> At the same time, Article 30 WFD mandates the European Environment Agency to report on the waste prevention efforts of Member States in annual progress reports.<sup>66</sup>

### **2.2.3. German Waste Plan. Business and Waste Focus**

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<sup>61</sup> Final Report on behalf of German Environment Agency “Appropriate Evaluation Benchmarks and Indicators for Measuring the Success of Waste Prevention Measures,” 2019, p.18. Available at [https://www.umweltbundesamt.de/sites/default/files/medien/1410/publikationen/2019-07-18\\_texte\\_80-2019\\_av-indikatoren\\_en.pdf](https://www.umweltbundesamt.de/sites/default/files/medien/1410/publikationen/2019-07-18_texte_80-2019_av-indikatoren_en.pdf) (Accessed March 15th 2020).

<sup>62</sup> German Life-Cycle Management Act (Kreislaufwirtschaftsgesetz) (Gesetz zur Förderung der Kreislaufwirtschaft und Sicherung der umweltverträglichen Bewirtschaftung von Abfällen), entered into force on March 1, 2012, German Federal Law Gazette I, p. 212 (BGBl. I S. 212).

<sup>63</sup> Finnish Waste Act (Jätelaki) Finnish Legal Gazette No. 646/2011.

<sup>64</sup> Waste Framework Directive, art. 29.

<sup>65</sup> Final Report on behalf of German Environment Agency 2019, p.10.

<sup>66</sup> Waste Framework Directive, art. 30.

Under Section 33 (3) No. 4 KrWG, “the waste prevention programme shall set appropriate, specific, qualitative or quantitative benchmarks for established waste prevention measures, against which progress achieved in the measures shall be monitored and evaluated; indicators or other appropriate specific qualitative or quantitative targets may be used as benchmarks”.<sup>67</sup>

In 2013, the federal government of Germany adopted a national waste prevention programme with the participation of the federal states. The programme recommends implementing various measures “after review of the respective costs and benefits by the respective stakeholder”.<sup>68</sup> In contrast to other EU Member States, Germany is pursuing a conceptual approach that has so far refrained from setting quantified targets and instead relies on a strategic dialogue with stakeholders and actors.<sup>69</sup>

This approach was adopted to both motivate stakeholders to take own responsibility for examining and implementing waste prevention measures and to enable them to specifically address waste prevention potentials and their barriers during implementation.<sup>70</sup> The chosen conceptual approach which, as outlined above, aims instead at broad, decentralised implementation of waste prevention measures is particularly concerned with presenting the state of implementation of the national waste prevention programme in a “measurable” and thus assessable way.<sup>71</sup>

Identifying concrete quantitative or qualitative indicators poses a particular challenge in view of the complexity and variety of concrete waste prevention measures, the affected waste streams and the groups of stakeholders involved at various levels (federal, state and municipal authorities). In addition, the decline in volumes of individual waste streams cannot directly be attributed to the effects of waste prevention measures.<sup>72</sup> This addresses the fundamental problem of measuring waste prevention measures that the development of individual waste streams cannot be seriously traced back to concrete waste prevention measures.<sup>73</sup>

In general, in 2019 Final Report on behalf of German Environment Agency it is pointed out that there is considerable uncertainty or need for research regarding the issue of possible waste prevention targets that can be measured in terms of degree of fulfilment by waste prevention indicators.<sup>74</sup> Politically agreed targets exist only in individual cases such as food waste prevention while there are still no suitable targets for the vast majority of waste or material

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<sup>67</sup> Final Report on behalf of German Environment Agency 2019, p.18.

<sup>68</sup> Ibid.

<sup>69</sup> Ibid.

<sup>70</sup> Ibid.

<sup>71</sup> Ibid.

<sup>72</sup> Ibid.

<sup>73</sup> Ibid, p.27.

<sup>74</sup> Ibid, p.76.

flows or waste prevention activities.<sup>75</sup> The analysis of the European and international waste prevention programmes shows, that in many cases such targets have been set politically in order to create incentive structures and connecting factors for actors in waste prevention. In the vast majority of cases, there is no scientific basis for these targets.<sup>76</sup>

Analysis of German waste prevention measures show that when it comes to companies there is a big support for promotion of voluntary activities and training, consultation schemes with the assistance of local authorities. “With regard to measures aimed at waste prevention in companies, special attention should be given to promoting environmental management systems (EMS) and their expansion to include waste pre-vention issues: [...] Additionally, the various regional and local training and consultation programmes for companies aimed at improving or optimising resource conservation and waste prevention shall continue to be supported by the local competent authorities and their use and visibility shall be developed and promoted where possible and appropriate.”<sup>77</sup>

Therefore it can be concluded that regarding business Germany waste prevention policy is much oriented to support waste prevention activities in companies.<sup>78</sup> It is preferred to learn from companies more than guide them directly what to do. For instance programme is oriented at gathering information or possibly on measures that are already sufficiently implemented by non-state actors, e.g. due to identified cost reduction potentials.<sup>79</sup> It is also emphasized that “waste prevention cooperation among industrial companies” should play a big role.<sup>80</sup>

#### **2.2.4. Finnish Waste Plan. Business and Waste Focus**

The Recent Finnish Waste Plan<sup>81</sup> presents the target state to 2030 in waste management and the prevention of waste generation and it lays down detailed targets to 2023 as well as the measures to be undertaken in order to achieve these targets.<sup>82</sup> The Waste Plan consists of both a waste management plan and a plan for reducing the quantity and harmfulness of waste and it covers the entire geographical territory of Finland, with the exception of the Åland Islands. The Plan also includes the longer-term target state to 2030 in waste management and to reduce the

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<sup>75</sup> Ibid.

<sup>76</sup> Ibid, p.76.

<sup>77</sup> Ibid, p.55.

<sup>78</sup> Ibid, p.56.

<sup>79</sup> Ibid, p.76.

<sup>80</sup> Ibid, p.55.

<sup>81</sup> Finnish National Waste Plan to 2023 “From Recycling to a Circular Economy”, (The Finnish Environment 01/2018). Available at [http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/160889/SY\\_01en\\_18\\_WEB.pdf?sequence=1](http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/160889/SY_01en_18_WEB.pdf?sequence=1) (Accessed 3d May 2020).

<sup>82</sup> Ibid, p.11.



quantity and harmfulness of waste. It is presumed in the Plan that high standard waste management is a part of the sustainable circular economy.<sup>83</sup>

The measures in the Waste Plan are to heighten environmental awareness and expertise relating to the circular economy and waste. Realization of the plan will also create conditions and opportunities for introducing new circular economy approaches and economically viable business concepts.<sup>84</sup>

The Plan's targets and measures aim to control the rise in waste quantities and to boost recycling. A further aim is materials cycle safety. The Waste Plan includes the key means and those deemed most effective in preventing the generation of waste.<sup>85</sup> The plan presents financial and administrative policy instruments, as well as a range of voluntary tools such as promotion of research and development, information and communications, and agreements and approaches for the business community.<sup>86</sup> The key principles of the WFD, including the principles of self-sufficiency and proximity and the order of priority in waste management, have been taken into account in the targets and measures in the Waste Plan.<sup>87</sup>

The plan among others presents measures suggested during the planning phase for actors other than central government, such as enterprises, NGOs and local government. While these suggested measures promote the achievement of the targets, actors in the sector are free to utilise also other tools to promote their achievement.<sup>88</sup>

Under the Finnish Waste Plan, the circular economy and industrial symbioses are highlighted to encourage the centralisation of waste treatment functions to allow synergies to be achieved among the various actors.<sup>89</sup> New high-quality ways of recycling wood and plastic packaging as well as forms of cooperation between producer organisations and recyclers are to be developed with active role of industry.<sup>90</sup>

One of the central impacts of the Finnish Waste Plan that have to do with increased sustainable and safe use of resources and the advancement of environmental protection is the "investment in and focus on the provision of training and information to enterprises, government and the public, along with new approaches and forms of cooperation between enterprises and the public sector that will serve to augment understanding of the circular economy and waste as well as environmental awareness and expertise".<sup>91</sup>

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<sup>83</sup> Ibid, p.11.

<sup>84</sup> Ibid, p.13.

<sup>85</sup> Ibid, p.15.

<sup>86</sup> Ibid.

<sup>87</sup> Ibid.

<sup>88</sup> Ibid.

<sup>89</sup> Ibid, p.22.

<sup>90</sup> Ibid, p.46.

<sup>91</sup> Ibid, p.55.

For the most part, the impacts of the Waste Plan on the economy will be favourable through e.g. new business relating to recycling, a rise in the rate of employment, and investment in facilities.<sup>92</sup> When addressing general measures to achieve target rate the Plan emphasizes that material efficiency will rise in the public and private sectors by means of voluntary agreements and audits, permit procedures and public procurement. The increased provision of training and advice will enhance an understanding of approaches to advance the circular economy.<sup>93</sup>

The Plan also introduces monitoring approach based on the WFD that requires the implementation and effectiveness of the National Waste Plan and the programme to reduce the quantity and harmfulness of waste to be evaluated at least every sixth year and when necessary, a revised plan to be prepared for adoption by the Government.<sup>94</sup> The implementation of the Waste Plan will be monitored with both quantitative and qualitative indicators (not alike Germany).

### **2.2.5. Comparison of German and Finnish Approaches to Waste and Business**

Summing up the German and Finnish approaches regarding business role in waste prevention it is to be concluded that both countries are more likely to learn from business and apply advice and support tactics. It is preferred to study companies' voluntary initiatives as examples, motivate to take own responsibility for examining and implementing waste prevention measures and to enable to specifically address waste prevention potentials and barriers during implementation. It was beneficial to discover that Member States do not guide precisely the industry using much the instruments of top-bottom approach, but are more likely to use the bottom-up one. Here we mean that neither Finnish or German policymakers plan to impose strict rules on what should be considered to be due and only waste prevention and management strategy for business. Both Member States tend to implement more flexible and stakeholder-oriented approach relying on a strategic dialog with stakeholders and actors. Germany is especially open to such a dialog. However, Finland is also aimed at implementing voluntary tools when it comes to companies.<sup>95</sup>

In the context of this research an important issue was noticed in the policies - the willingness of states to promote new approaches and forms of cooperation between the

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<sup>92</sup> Ibid.

<sup>93</sup> Ibid.

<sup>94</sup> Ibid, p.57.

<sup>95</sup> See more about the need of participatory research approaches, collaboration between stakeholders and actors, exploring opinions and future views, facilitating shared understandings in forest-based sector in Finland in Näyhä, A.: Transition in the Finnish forest-based sector: Company perspectives on the bioeconomy, circular economy and sustainability, Journal of Cleaner Production, February 2019, Volume 209, pp. 1294-1306.

enterprises. If a green light is given by the States for companies to cooperate in new forms in order to enhance circular economy – the practice of companies’ voluntary standards within their supply chain will certainly not be enough.<sup>96</sup> Companies need certain safeguards that even when changing their usual contract role to being Suppliers themselves they can still comply with those high voluntary standards they set within their supply chain and new contractors will follow those standards as well.

More to that, the analysis show that on policymaking level Finland and Germany have different attitudes towards assessing waste prevention measures. Germany honestly claims that prefer to refrain from setting quantified targets, assuming that such targets are politically set and lack scientific basis. Finland still relies on such numerical indicators but also with a range of qualitative. The latter may negatively affect those companies that have production assets in both Member States. Such companies will have to adapt to the different approaches of national governments towards implementing the WFD rules on Waste Plans. That suits a good example that the WFD implementation on the MS is not harmonized enough and constitutes a stumbling block for companies to rely on circular economy law while making a sustainable shift to circular economy.

## **2.3. CJEU Case Law Study: End-of-Waste Status and Precautionary Principle**

### **2.3.1. Waste Status**

Turning from tendencies in policymaking reflected in German and Finnish Waste Plans – those with bottom-up approach towards business waste management incentives, we will look at the practical issues and study recent CJEU case law. The latter concerns end-of-waste status and precautionary principle – both the cornerstones of the WFD and its national level implementation agenda. We are to focus on the possible challenging aspects associated with concepts’ business application for those companies that are aimed at minimizing waste through recycling and recovering.

As a starting point we can address the recent CJEU decision in case C-624/17,<sup>97</sup> dedicated to the concept of ‘waste’. The Court points out, that regarding the concept of ‘waste’, it should be borne in mind that Article 3(1) of the WFD defines it as any substance or object

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<sup>96</sup> In the next chapter voluntary standards set by companies will be presented and analyzed, those that are promoted throughout supply chain and within contract model Demand-Supply.

<sup>97</sup> Case C-624/17 *Openbaar Ministerie v Tronex BV*, (Second Chamber, 4 July 2019), ECLI:EU:C:2019:564, para.16.

which the holder discards or intends or is required to discard.<sup>98</sup> In accordance with the Court's settled case-law, the classification of a substance or object as waste is to be inferred primarily from the holder's actions and the meaning of the term 'discard'.<sup>99</sup>

As regards the meaning of the term 'discard',<sup>100</sup> it also follows from the Court's settled case-law that that term must be interpreted in the light of the aim of the WFD, which, in the words of recital 6 thereof, is to minimise the negative effects of the generation and management of waste on human health and the environment, having regard to Article 191(2) TFEU, which provides that EU policy on the environment is to aim at a high level of protection and is to be based, in particular, on the precautionary principle and the principle that preventive action should be taken. It follows that the term 'discard', and therefore the concept of 'waste' cannot be interpreted restrictively.<sup>101</sup>

More specifically, the existence of 'waste', within the meaning of WFD, must be determined in the light of all the circumstances, regard being had to the aim of that directive and the need to ensure that its effectiveness is not undermined.<sup>102</sup>

Thus, certain circumstances may constitute evidence that a substance or object has been discarded or of an intention or requirement to discard it within the meaning of Article 3(1) of the WFD.<sup>103</sup> Particular attention must be paid to the fact that the object or substance in question is not or is no longer of any use to its holder and such that that object or substance constitutes a burden which he will seek to discard. In such a case, there is a risk that the holder will dispose of the object or substance in his possession in a way likely to cause harm to the environment, particularly by dumping it or disposing of it in an uncontrolled manner.<sup>104</sup> Being a subject to the provisions of the WFD, which means that object or substance falls within the concept of waste, the recovery or disposal of that object or substance must be carried out in such a way that human health is not endangered and without using processes or methods likely to harm the environment.<sup>105</sup>

In that regard, the degree of probability that goods, a substance or a product will be reused without a prior processing operation constitutes a criterion relevant to assessing whether or not they constitute waste within the meaning of the WFD. If, beyond the mere possibility of reusing the goods, substance or product in question, there is also a financial advantage for the

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<sup>98</sup> Ibid.

<sup>99</sup> Joined Cases C-241/12 and C-242/12 *Shell Nederland Verkoopmaatschappij BV and Belgian Shell NV* (First Chamber, 12 December 2013), ECLI:EU:C:2013:821, para. 37.

<sup>100</sup> It is apparent from the provisions of the WFD that the term 'discard' covers both recovery and disposal of a substance or object, within the meaning of Article 3(15) and (19) of that directive. See Case C-624/17, para p.18.

<sup>101</sup> Ibid.

<sup>102</sup> Joined Cases C-241/12 and C-242/12, para. 40.

<sup>103</sup> Ibid, para. 21.

<sup>104</sup> Ibid, para. 22.

<sup>105</sup> Ibid.

holder in so doing, the likelihood of such reuse is high. In such circumstances, the goods, substance or product in question must no longer be regarded as a burden which its holder seeks to ‘discard’, but as a genuine product.<sup>106</sup>

It comes from the above CJEU’s legal argumentation that both “waste” and “discard” are concepts that are to be interpreted widely and the final and detailed assessment is to be provided by the national courts on a case-by-case basis.<sup>107</sup> Therefore multinational business operating in the EU and willing to comply with the WFD waste rules is to orient at national legislation and might face challenges associated with diverse interpretative practice regarding waste status in different Member States.

### **2.3.2. End-of-Waste Status**

The concept of waste is only the one of the headstones of the WFD especially relevant to circular economy and its waste prevention and management focus. “End-of-waste” concept is another important issue to address.

According to the CJEU interpretation, Article 6(1), first subparagraph, of the WFD merely sets out the conditions to be met by the specific criteria which make it possible to determine which waste ceases to be waste, within the meaning of Article 3(1) of that directive, when it has undergone a recovery, including recycling, operation.<sup>108</sup> Therefore, such conditions cannot, in themselves, make it possible directly to establish that certain waste must no longer be regarded as such. Furthermore, it is common ground that such specific criteria have not been laid down by European Union law.<sup>109</sup> Where specific criteria have not been laid down by EU law Member States may, by virtue of Article 6(4) of the WFD, decide on a case-by-case basis whether certain waste has ceased to be waste, taking into account the applicable case-law.<sup>110</sup>

Even where waste has undergone a complete recovery operation which has the consequence that the substance in question has acquired the same properties and characteristics as a raw material, that substance may none the less be regarded as waste if, in accordance with the definition in Article 3(1) of the WFD, its holder discards it or intends or is required to discard it. It is for the national court to carry out the assessments necessary in that regard.<sup>111</sup> Therefore, first important conclusion can be made: waste can still remain waste even after complete

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<sup>106</sup> Ibid, para. 23.

<sup>107</sup> Ibid, paras 24-25.

<sup>108</sup> C-358/11 *Lapin luonnonsuojelupiiri* (Second Chamber, 7 March 2013), ECLI:EU:C:2013:142, para.55.

<sup>109</sup> Ibid.

<sup>110</sup> Ibid, para. 56.

<sup>111</sup> Ibid, para. 57.

recovery and acquiring of properties and characteristics as a raw material if its holder discards it or intends or is required to discard it.

The fact that a substance is the result of a recovery operation within the meaning of the WFD is only one of the factors which must be taken into consideration for the purpose of determining whether that substance is still waste, but does not as such permit a definitive conclusion to be drawn in that regard.<sup>112</sup> Recovery operation ability to transform object into usable object should be determined in accordance with art 1 and 13 of directive – without endangering human health or harming the environment. The Court points it out this way: “it is necessary to determine, in the light of all the facts of the case, whether that object may be used in accordance with the requirements of the WFD, as set out in particular in Articles 1 and 13 thereof, without endangering human health or harming the environment”.<sup>113</sup>

The end-of-waste status of a substance or object is thus subject to two conditions. First, in accordance with Article 3(1) of the Waste Directive, the holder of the substance or object in question must not discard it or intend or be required to discard it. Secondly, a recovery operation must enable the substance or object to be made usable without endangering human health or harming the environment.<sup>114</sup>

The Court continued its interpretation in the case C–60/18 28<sup>115</sup> analyzing more precisely the measures of Member States regarding defining the end-of-waste status of a substance or object. The court emphasized that under recitals 28 and 29 of WFD the latter should help move the EU closer to a “recycling society”, seeking to avoid waste generation and to use waste as a resource. States should support the use of recyclates ... in line with the waste hierarchy and with the aim of a Member recycling society, and should not support the landfilling or incineration of such recyclates whenever possible.<sup>116</sup>

In this case the CJEU again assesses the situation when no rules have been adopted on the EU level in relation to the object at question, which has undergone a recovery operation.<sup>117</sup> The Court reaffirms that in such circumstances, Member States may decide on a case-by-case basis whether certain waste has ceased to be waste, while being obliged, where WFD, as amended WFD, so requires, to notify the Commission of technical standards and rules adopted in that regard.<sup>118</sup>

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<sup>112</sup> Ibid, para. 58.

<sup>113</sup> Ibid, para. 59.

<sup>114</sup> Ibid, para. 39.

<sup>115</sup> Case C–60/18 AS Tallinna Vesi v Keskkonnaamet (Second Chamber, 28 March 2019), ECLI:EU:C:2019:264, para. 4.

<sup>116</sup> Ibid.

<sup>117</sup> Ibid, para. 20.

<sup>118</sup> Ibid, para. 21.

It should be noted, in the first place, that the EU legislature thus specifically provided that Member States are entitled to adopt measures relating to end-of-waste status of a substance or object, without, however, specifying the nature of those measures.<sup>119</sup> In that regard, it must be noted that the measures adopted on the basis of Article 6(4) of the WFD — in the same way as the EU regulations adopted on the basis of paragraph 2 of that article — result in the end-of-waste status of waste and, therefore, in the end of the protection that the law governing waste guarantees as regards the environment and human health.<sup>120</sup> Those measures must therefore comply with the requirements laid down in paragraph 1(a) to (d) of Article 6 and, in particular, take account of any possible adverse impact that the substance or object concerned may have on the environment and on human health.<sup>121</sup>

Hence, the main point here to pay a close attention to is that measures by Member States should take account of any possible adverse impact that the substance or object concerned may have on the environment and on human health. It also follows from the wording of Article 6(4) of the WFD that Member States may provide for the possibility of decisions in individual cases, in particular on the basis of applications submitted by holders of the substance or object classified as waste, but that they may also adopt technical standards or regulations concerning certain categories of waste or a specific type of waste.<sup>122</sup>

Therefore, in a situation of no criteria set on the EU level the destiny of the object depends on the existence of criteria laid down in a generally applicable national legal act concerning that type of waste. Member States may also decide that some waste cannot cease to be waste and to refrain from adopting legislation concerning the end-of-waste status.<sup>123</sup>

However, citing the Advocate General Opinion (point 44), the Court concluded that the Member State must ensure that such abstention does not amount to an obstacle to the attainment of the objectives set by the WFD, such as encouraging the application of the waste hierarchy or encouraging the recovery of waste and the use of recovered material in order to preserve natural resources and to enable the development of a circular economy.<sup>124</sup>

Advocate General's Opinion<sup>125</sup> in this case is also worth mentioning, especially regarding the explanation of the substance of Court's notion "case law that Member States should take into account." Advocate General notes that it is necessary to strike an appropriate balance between the objectives pursued by the Waste Directive, that is to say, on the one hand, to

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<sup>119</sup> Ibid, para. 22.

<sup>120</sup> Ibid, para. 23.

<sup>121</sup> Ibid.

<sup>122</sup> Ibid, para. 24.

<sup>123</sup> Ibid, para. 26.

<sup>124</sup> Ibid, para. 27.

<sup>125</sup> Case C-60/18 AS Tallinna Vesi v Keskkonnaamet (Advocate General Opinion, 29 November 2018), ECLI:EU:C:2018:969.

ensure a high level of protection and, on the other hand, where possible, to recover waste in the form of useable products.<sup>126</sup>

The Member States do have some discretion when it comes to achieving the objectives pursued by the Waste Directive, in particular those relating to the protection of public health and the environment, set out in Article 13. This is because such measures require a complex assessment of the risks associated with the recovery operation in question on the basis of the most recent state of scientific and technical knowledge.<sup>127</sup> EU law allows the judicial review of such decisions to be restricted to manifest errors of assessment, but requires the competent authorities to respect the procedural requirements, which is to say, in particular, that they must carefully and impartially examine all relevant aspects of the individual case. That discretion must also be available to them in the balancing operation necessary in the context of the application of the fundamental rights concerned.<sup>128</sup>

### **2.3.3. Precautionary Principle in Correlation with End-of-Waste Status**

In case C-212/18<sup>129</sup>, both end-of-waste status and precautionary principle are discussed.

The Court concluded that Article 6(4) of WFD does not, in principle, allow a waste holder to demand the recognition of end-of-waste status by the competent authority of the Member State or by a court of that Member State.<sup>130</sup> However, once the matter is being litigated, it is for the national court, which alone has jurisdiction to establish and assess the facts, to determine whether particular procedural arrangement (refraining from laying down criteria for determining end-of-waste status) results from a justified application of the precautionary principle.<sup>131</sup>

It should be emphasized that, in accordance with the precautionary principle laid down in Article 191(2) TFEU, if, after examining the best available scientific information, there remains uncertainty as to whether the use, in specific circumstances, of a substance derived from the recovery of waste is devoid of any possible adverse impact on the environment and human health, the Member State must refrain from laying down criteria for determining end-of-waste

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<sup>126</sup> Ibid, para. 26.

<sup>127</sup> Ibid, para. 46.

<sup>128</sup> Ibid. Here Advocate General means respect to the fundamental rights (including right to property under art 17 Charter of Fundamental Rights and freedom to conduct a business under Article 16).

<sup>129</sup> Case C-212/18, Prato Nevoso Termo Energy (Second Chamber, 24 October 2019), ECLI:EU:C:2019:898, para. 36.

<sup>130</sup> Ibid, para. 38.

<sup>131</sup> Ibid, para. 44.



status as regards that substance or making provision for an individual decision recognising that end-of-waste status.<sup>132</sup>

Advocate General opinion in this case is worth addressing. Advocate General summarizes that recognition that waste has acquired end-of-waste status may be given in three distinct ways. First, such recognition may be based on the application of end-of-waste status criteria, referring to the specific categories of waste defined, at EU level, in Article 6(2) of the WFD.<sup>133</sup> Second, in the absence of such criteria, such recognition may be given by means of a ‘case-by-case’ decision — that is to say, an individual decision referring to the streams of specific waste recovered in a specific plant — adopted by a Member State under Article 6(4) of that directive.<sup>134</sup> Third, as is apparent from the judgment in *Tallinna Vesi*, that provision authorizes Member States to draw up themselves, in the absence of criteria laid down at EU level, the criteria according to which waste in a certain category ceases to be waste, by means of a domestic measure of general application.<sup>135</sup>

Advocate General also emphasized that the objective of environmental protection pursued by the WFD is broken down into two aspects: first, preventing or reducing the adverse impacts caused by waste and, second, improving the efficiency of the management of resources.<sup>136</sup> However, the uncertainty surrounding the status of waste that has undergone a recovery operation is likely to encourage holders of waste to eliminate it, thus ignoring the waste hierarchy, instead of recovering it.<sup>137</sup>

Advocate General considers that, in the absence of harmonised criteria, a Member State should not, in principle, be required to initiate a procedure for the adoption of criteria or to make provision for an individual assessment of end-of-waste status when the national legislature considers that the conditions laid down in Article 6(1) of the WFD cannot be satisfied in the case of a certain type of waste.<sup>138</sup> On the other hand, Member State may place the burden of proving necessary elements on the person who relies on them, provided that it does not make such proof excessively difficult.<sup>139</sup>

In general, the competent national authorities cannot, in Advocate’s General view, adopt a passive approach that would impede the adoption of necessary criteria or, at the very least, the initiation of a procedure that would permit the examination of the elements put forward by the

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<sup>132</sup> Ibid, para. 58.

<sup>133</sup> Case C-212/18 Prato Nevoso Termo Energy (Advocate General Opinion, 20 June 2019), ECLI:EU:C:2019:520, para. 34.

<sup>134</sup> Ibid.

<sup>135</sup> Ibid.

<sup>136</sup> Ibid, para. 40.

<sup>137</sup> Ibid.

<sup>138</sup> Ibid, para. 56.

<sup>139</sup> Ibid, para. 47.

waste holders concerned.<sup>140</sup> The attainment of the objective of promoting waste recovery requires that the establishment of end-of-waste status criteria may be studied in the context of a procedure whose rules, laid down by national law, comply with the principle of the effectiveness of EU law. That principle means, in Advocate's General view, that the waste holders concerned may request that the procedure for the adoption of such criteria be initiated and may have remedies available where such a request is rejected or where the competent national authorities fail to act. The principle of effectiveness also assumes that that procedure will be subject to reasonable time limits.<sup>141</sup>

In addition the precautionary principle was a subject of the Court's analysis in joined Cases C-487/17 to C-489/17.<sup>142</sup>

The CJEU inferred that, where it proves to be impossible to determine with certainty the existence or extent of the alleged risk because of the insufficiency, inconclusiveness or imprecision of the results of studies conducted, but the likelihood of real harm to the environment persists should the risk materialise, the precautionary principle justifies the adoption of restrictive measures, provided they are non-discriminatory and objective.<sup>143</sup>

It follows that the EU legislature, in the specific area of waste management, intended to strike a balance between, on the one hand, the precautionary principle and, on the other, technical feasibility and economic viability, such that waste holders are not required to ensure that the waste in question is devoid of any hazardous substance, but may confine themselves to ascertaining the substances which may reasonably be found in that waste and assessing its hazardous properties on the basis of calculations or through tests relating to those substances.<sup>144</sup>

Here we see a strong interpretation of precautionary principle.

To sum it up, finding an answer whether particular object or substance ceased to be waste constitutes a challenging task. This is especially the case, when no criteria is set on the EU level as the answer is to be given on a Member State level, most probably within a litigation initiated by business itself. In this respect in a case-by-case manner several interdependent factors are to be considered carefully and comprehensive balance test is to be made. The balance would be stroke between the environmental protection principles of precaution and sustainability and technical feasibility and economic viability, protection of resources as well as the overall environmental, human health, economic and social impacts. This should be rather time-capturing and costs-demanding process with no clear result foreseen for business.

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<sup>140</sup> Ibid, para. 59.

<sup>141</sup> Ibid, para .59.

<sup>142</sup> Joined Cases C-487/17 to C-489/17, Verlezza and Others, (Tenth Chamber, 28 March 2019), ECLI:EU:C:2019:270, para. 57.

<sup>143</sup> Ibid, para. 58.

<sup>144</sup> Ibid.

## **2.4. Conclusion**

In this chapter we addressed the major EU policy making documents: EU Circular Economy Action Plan and Monitoring Framework that highlighted the importance of shift to circular economy and the role of business. We focused on the waste prevention and management aspects. Then turned to the main lever for the mentioned policies – EU Waste Framework Directive and its obligation towards Member States to develop and monitor Waste Prevention Plans.

We examined German and Finnish Waste Prevention Plan's general issues and the role they give to the business. The conclusion was made that both states are more likely to learn from business and apply advice and support tactics, preferring to use companies' voluntary initiatives as an example or object for further studies when it comes to develop the waste prevention policies. It was interesting to find out that Member States at question do not guide and command precisely the industry with the instruments of top-down approach, but are more likely to use the bottom-up tools. In the context of this research an important issue noticed in the policies is the willingness of states to promote new approaches and forms of cooperation between the enterprises that gives special light to the problem of supply chain limitation of voluntary standards that we will address in the next chapter.

We also looked at the core concepts of the WFD: waste, disposal, end-of-waste status, precautionary principle through the prism of the CJEU interpretation available in the recent cases. It gave an opportunity to conclude that the level of harmonization regarding interpretation of these concepts on the EU level is still much to be improved and Member States have a wide margin of discretion regarding waste hierarchy and certain rules regarding establishment of end-of-waste status. The latter is mostly to be assessed and decided by national administrative bodies or courts on a case-by-case basis. This brings too high level of uncertainty for business and most probably is associated by the companies with high time and financial costs risks.

The possible high liability risks should not be underestimated here as well. With so many factors to be assessed, for instance, in order to define whether object or substance ceased to be waste, including fundamental human rights to be taken into account, it becomes extremely challenging task and both costs and time demanding. The international increase in lawsuits against corporations, including parent corporations, for environmental harm allegedly caused by

their subsidiaries, and against lead corporations for negative environmental impacts in their global value chains, shows that the liability risk of unsustainability is materializing.<sup>145</sup>

There is strong evidence to believe that environment-related disputes are a major trend of nowadays. As J.E. Viñuales fairly points out, investment protection, for instance, can no longer be considered in isolation from the protection of other values such as human rights and environment and ignoring this trend would be a mistake, with very practical consequences for the assessment of litigation risk.<sup>146</sup>

We can also refer to the example of the European Court of Human Rights (ECtHR), that has already safeguarded the environment by proxy of first-generation human rights, the scope of which is constantly evolving and which are recognized as being independent and indivisible framework from economic and social rights, we may conclude that even human rights law – which is traditionally ignorant of any environmental considerations – is more likely to address contemporary planetary conundrums.<sup>147</sup>

Another example to highlight the fact that the liability risks associated with unsustainable business conduct should not be underestimated is from ADR sector. The latest ICC Commission Report claims that climate change related disputes will increase exponentially.<sup>148</sup>

To sum it up, in this chapter we investigated that examined circular economy law can't solely and efficiently answer the demand of business to sustainable shift to circular economy in a due time because it remains unprecise, unharmonised, develops too long. The more harmonized interpretation and implementation of end-of-waste rules across the EU must be enabled to further facilitate the use of recovered material.<sup>149</sup> The way rules on classification of waste are

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<sup>145</sup> Sjäfjell, B. - Mähönen, J. - Novitz, T. - Gammage, C. - Ahlström, H.: Securing the future of European business: SMART reform proposals, SMART Report (2020), p.12. Available at SSRN: <https://ssrn.com/abstract=3595048>. (Accessed 11th June 2020).

<sup>146</sup> Viñuales, Jorge E.: The Environment Breaks into Investment Disputes in International Investment Law, M. Bungenberg, J. Griebel, S. Hobe, A., Reinisch (eds), Munich/London: C.H. Beck/Hart/Nomos, 2012, p.25.

<sup>147</sup> Kobylarz, Natalia: The European Court of Human Rights: an Underrated Forum for Environmental Litigation in Sustainable Management of Natural Resources in Sustainable Management of Natural Resources. Legal Instruments and Approaches, Helle Tegner Anker and Birgitte Egelund Olsen (eds.), Cambridge-Antwerp-Portland, Intersentia, 2018, Chapter 7, pp.101-102. See also Council of Europe statement ahead of World Environmental Day (June 5 2020) "Beyond COVID-19, human rights can help save the planet" Available at [https://search.coe.int/directorate\\_of\\_communications/Pages/result\\_details.aspx?ObjectId=09000016809e8258](https://search.coe.int/directorate_of_communications/Pages/result_details.aspx?ObjectId=09000016809e8258) (Accessed 15th June 2020) and site of the conference that will be held on the premises of the ECtHR and under the Georgian chairmanship of the Committee of Ministers of the Council of Europe on the 5<sup>th</sup> October 2020 in Strasbourg, France. It aims at facilitating a debate between renowned practitioners and academic experts in the field of international environmental law and human rights <https://www.coe.int/en/web/portal/human-rights-for-the-planet> (Accessed 15th July 2020).

<sup>148</sup> ICC Commission Report "Resolving Climate Change Related Disputes through Arbitration and ADR", November 2019. Available at <https://iccwbo.org/content/uploads/sites/3/2019/11/icc-arbitration-adr-commission-report-on-resolving-climate-change-related-disputes-english-version.pdf> (Accessed 15th July 2020).

<sup>149</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Implementation of the Circular Economy Package: Options to Address the Interference Between Chemical, Product and Waste Legislation, COM (2018) 32 final, Strasbourg, 16.1.2018, p.5.

implemented and enforced has important consequences on future waste management choices, such as feasibility and economic viability of collection, recycling method or the choice between recycling and disposal.<sup>150</sup> Such discrepancies may have an impact upon the uptake of secondary raw materials<sup>151</sup> and it will take time to improve the situation within the instruments of circular economy law. However business needs rapid and up-to-date solutions, opportunity to act within the level playing field.

In the next chapter we will discover how companies go beyond mere compliance with circular economy law throughout volunteerism and whether the latter in a combination with circular economy law is enough to enhance circular economy.

### **3.VOLUNTARY COMMITMENTS. UPM AND STORA ENSO**

In this chapter we will investigate the voluntary commitments of two companies UPM - Kymmene and Stora Enso – those dedicated to circular economy and with waste prevention and management focus. As a starting point in this chapter we will give a short description of both companies, including jurisdiction of registration, divisions (sectoral and international), main manufacture purpose, business model. Then we will describe companies' attitude towards circular economy reflected in the available disclosure documents and introduce three voluntary standards with waste prevention and management focus. In the closing part of the chapter the conclusions regarding both: substantive and procedural dimensions of companies' voluntary standards will be presented.

#### **3.1. UPM Kymmene and Stora Enso. Basic Information**

##### **3.1.1. UPM**

UPM is a limited liability company with headquarters in Helsinki, Finland. The parent company UPM-Kymmene Corporation and its subsidiaries form UPM Group and have approximately 18,700 employees in 46 countries. UPM Group's business operations are divided into six business areas and global functions. UPM shares are listed on Nasdaq Helsinki Ltd.<sup>152</sup>

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<sup>150</sup> Ibid.

<sup>151</sup> Ibid p.6.

<sup>152</sup> UPM Corporate Governance Statement 2019.

Available at <https://www.upm.com/siteassets/asset/governance/documents/statements/upm-cg-statement-2019-en.pdf> (Accessed 3d May 2020).

Under the UPM Articles of Association, the name of the Company is UPM-Kymmene Oyj, in English UPM-Kymmene Corporation, and its domicile is Helsinki.<sup>153</sup> The Company's field of activity is directly, or through its subsidiaries or affiliated companies, to engage in forestry and forest, packaging, chemical and energy industries, to provide related services and to engage in other related business activities, to own, possess and trade in real estate, commodities, shares and other securities and to engage in other investment activities.<sup>154</sup>

In addition to the Articles of Association, the company follows, among others, the Finnish Companies Act<sup>155</sup> and other laws and regulations applicable to publicly listed companies in Finland, the Finnish Corporate Governance Code, Board and committee charters, corporate policies and rules, as well as rules and guidelines issued by the European Securities and Markets Authority, the Finnish Financial Supervisory Authority and the Nasdaq Helsinki stock exchange.<sup>156</sup>

The shareholders exercise their ownership rights through the shareholders' meetings. The decision-making bodies with responsibility for managing the Company are the Board and the CEO.<sup>157</sup> UPM's decision making, management and operations are guided by UPM values and UPM Code of Conduct. The latter form the framework for all company operations and set standards of behavior for all UPM employees including directors and executives.<sup>158</sup> The Board of Directors approved the updated version of UPM Code of Conduct in April 2019.<sup>159</sup>

All UPM suppliers and third-party intermediaries (e.g. agents, advisers, joint venture partners, local partners, or distributors acting on behalf of UPM) need to comply with the standards set in this UPM Supplier and Third-Party Code or demonstrate their compliance with similar standards defined in their own code of conduct or company policies. UPM's Supplier and Third-Party Code defines the minimum level of performance that UPM requires from all its suppliers and third parties. There are additional requirements for certain materials and services.<sup>160</sup> In an illustrative manner the UPM Supplier and Third-Party Code is complemented by Practical Guide to everyday decisions.<sup>161</sup>

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<sup>153</sup> Articles of Association, § 1. Available at <https://www.upm.com/investors/governance/governance-guidelines/articles-of-association/> (Accessed 3d May 2020).

<sup>154</sup> Ibid, § 2.

<sup>155</sup> Finnish Limited Liability Companies Act (Osakeyhtiölaki), Finnish Legal Gazette No. 624/2006.

<sup>156</sup> UPM Corporate Governance Statement 2019.

<sup>157</sup> Ibid.

<sup>158</sup> Ibid.

<sup>159</sup> UPM Code of Conduct. Available at <https://www.upm.com/siteassets/asset/governance/documents/policies/upm-code-of-conduct-wide-english.pdf> (Accessed 3d May 2020).

<sup>160</sup> Ibid.

<sup>161</sup> Practical Guide to Everyday Decision. Available at [https://www.upm.com/SysSiteAssets/documents/for-suppliers/upm\\_supplier\\_and\\_third\\_party\\_code\\_practical\\_en.pdf](https://www.upm.com/SysSiteAssets/documents/for-suppliers/upm_supplier_and_third_party_code_practical_en.pdf), (Accessed 3d May 2020).

UPM Supplier and Third-Party Code is based on the ten principles of the United Nations Global Compact initiative, the United Nations Guiding Principles on Business and Human Rights, and the International Labour Organization's Declaration on Fundamental Principles and Rights at Work.<sup>162</sup> UPM consists of six separate business areas: UPM Biorefining (including pulp, timber and biofuels businesses), UPM Energy, UPM Raflatac, UPM Specialty Papers, UPM Communication Papers and UPM Plywood.<sup>163</sup> UPM operates globally<sup>164</sup> with the two largest representations of assets in Europe: Finland and Germany.

The business model of the company is presented on its official site and is summarized as follows “Our business areas are competitive, with strong market positions and a leading financial and sustainability performance”.<sup>165</sup>

### **3.1.2. Stora Enso**

Under the Stora Enso Articles of Association, the name of the Company is Stora Enso Oyj, and its domicile - the City of Helsinki.<sup>166</sup>

The Company operates directly or through subsidiaries and associated companies in the forest, engineering and chemical industries and other manufacturing industries; engages in agriculture, forestry and merchant shipping, as well as in mining industry, supply of hydro-power, building of hydro-electric facilities and financing. The Company may also engage in the sale of know-how and services in its own field of operations and carry out construction, operational, marketing and other corresponding assignments both in Finland and abroad.<sup>167</sup>

The duties of the various bodies within Stora Enso are determined by the laws of Finland and by the Company's corporate governance policy, which complies with the Finnish Companies Act and the Finnish Securities Market Act.<sup>168</sup> The rules and recommendations of the

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<sup>162</sup> Ibid.

<sup>163</sup> UPM Annual Report 2019 p. 35 available at: <https://user-fudicvo.cld.bz/UPM-Annual-Report-2019> (Accessed 3d May 2020).

<sup>164</sup> UPM operates in: Finland, Estonia, Poland, Germany, Italy, France, Austria, Spain, UK, Turkey, Russia, China, India, Indonesia, South Africa, US, Mexico, Brazil, Uruguay, Thailand, Vietnam, Singapore, Australia and New Zealand. Map available at <https://www.upm.com/businesses/where-we-operate/> (Accessed July 10th 2020).

<sup>165</sup> More details about UPM business model available at <https://www.upm.com/investors/upm-as-an-investment/business-model/> (Accessed July 10th 2020).

<sup>166</sup> Stora Enso Articles of Association, § 1. Available at [https://www.storaenso.com/-/media/documents/download-center/documents/company-information/articles-of-association\\_eng.pdf](https://www.storaenso.com/-/media/documents/download-center/documents/company-information/articles-of-association_eng.pdf) (Accessed 3d May 2020).

<sup>167</sup> Ibid, § 2.

<sup>168</sup> Finnish Securities Markets Act (Arvopaperimarkkinalaki), Finnish Legal Gazette No. 746/2012.

Nasdaq Helsinki Oy and Nasdaq Stockholm AB stock exchanges are also followed, where applicable.<sup>169</sup>

Stora Enso complies with the Finnish and the Swedish Corporate Governance Codes,<sup>170</sup> with the exception of the deviations due to differences between the Swedish and Finnish legislation, governance code rules and practices, and in these cases Stora Enso follows the practice in its domicile.<sup>171</sup>

The shareholders exercise their ownership rights through the shareholders' meetings. The decision-making bodies with responsibility for managing the Company are the Board and the CEO.<sup>172</sup> The Board and the President and CEO are responsible for the management of the Company. Other governance bodies have an assisting and supporting role.<sup>173</sup>

The Stora Enso Code – Stora Enso's Code of Conduct – is a single set of values for all employees, a guideline that explains company's approach to ethical business practices, human and labour rights, as well as environmental values.<sup>174</sup>

The Supplier Code of Conduct outlines the minimum standards Stora Enso requires its Suppliers to comply with when doing business with Stora Enso in addition to observing all laws and regulations governing their activities. Further guidance on how to interpret and implement The Supplier Code of Conduct is given in the Practical Guide for Stora Enso Suppliers.<sup>175</sup> The Code of Conduct forms an integral part of all contracts between the Supplier and Stora Enso<sup>176</sup>

Stora Enso consists of six divisions: Packaging Materials, Packaging Solutions, Biomaterials, Wood Products, Forest and Paper.<sup>177</sup> Stora Enso has operations on all continents

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<sup>169</sup> Stora Enso Corporate Governance Policy, p.1. Available at [https://www.storaenso.com/-/media/documents/download-center/documents/company-information/stora-enso-cg-policy\\_january-2020\\_final.pdf](https://www.storaenso.com/-/media/documents/download-center/documents/company-information/stora-enso-cg-policy_january-2020_final.pdf) (Accessed July 3d May 2020).

<sup>170</sup> Finnish Corporate Governance Code 2020. Available at <https://cgfinland.fi/en/corporate-governance-code/>, Accessed July 10th 2020, Swedish Corporate Governance Code 2018. Available at [https://ecgi.global/sites/default/files/scgb\\_annual\\_report\\_2018.pdf](https://ecgi.global/sites/default/files/scgb_annual_report_2018.pdf), (Accessed 3d May 2020).

<sup>171</sup> Stora Enso Corporate Governance Policy, p.1. Available at [https://www.storaenso.com/-/media/documents/download-center/documents/company-information/stora-enso-cg-policy\\_january-2020\\_final.pdf](https://www.storaenso.com/-/media/documents/download-center/documents/company-information/stora-enso-cg-policy_january-2020_final.pdf) (Accessed 3d May 2020).

<sup>172</sup> Stora Enso Corporate Governance 2019, p.2. Available at [https://www.storaenso.com/-/media/documents/download-center/documents/annual-reports/2019/storaenso\\_governance\\_2019.pdf](https://www.storaenso.com/-/media/documents/download-center/documents/annual-reports/2019/storaenso_governance_2019.pdf) (Accessed 3d May 2020).

<sup>173</sup> Ibid.

<sup>174</sup> Stora Enso Code of Conduct. Available at <https://codeofconduct.storaenso.com/en> (Accessed July 10th 2020).

<sup>175</sup> Practical Guide for Stora Enso's Suppliers. Available at <http://storaensowald.at/wp-content/uploads/2015/12/A-practical-guide-for-stora-ensos-suppliers-english.pdf> (Accessed 3d May 2020).

<sup>176</sup> Stora Enso Supplier Code of Conduct, p.1. Available at: [https://www.storaenso.com/-/media/documents/download-center/documents/suppliers/se-supplier-coc\\_legal-document\\_en.pdf](https://www.storaenso.com/-/media/documents/download-center/documents/suppliers/se-supplier-coc_legal-document_en.pdf) (Accessed 3d May 2020).

<sup>177</sup> Stora Enso Divisions. Available at: <https://www.storaenso.com/en/about-stora-enso/our-divisions> (Accessed 10th July 2020).



with focus on utilizing expertise in renewable materials and creating value in pulp, paper, packaging and wood.<sup>178</sup>

### **3.2. UPM and Stora Enso. Purpose and Circular Economy Vision**

Both companies emphasize that their purpose is not just short-time value creation but is defined by the long-term perspective. UPM while describing its vision and purpose puts it this way: “We create value by seizing the limitless potential of bioeconomy”.<sup>179</sup> Stora Enso defines its purpose as follows: “Our purpose “Do good for people and the planet. Replace non-renewable materials with renewable products”.<sup>180</sup>

Both companies’ voluntary standards pay close attention to circular economy.

According to UPM the circular economy addresses two key global challenges of our time: climate change and the growing scarcity of natural resources.<sup>181</sup> UPM’s circular approach boils down to three statements: “More with Biofore. We reuse or recycle virtually all our production waste. We recycle materials and products several times, and we create added value through smart solutions”.<sup>182</sup> Company’s goal is to minimise waste and maximise reuse.

Efficient use of renewable wood is at the core of UPM business. This means company reuses or recycles most of its production waste, which is utilised either as raw material or in energy production.<sup>183</sup> For UPM reusing waste or residues in innovative products is also a way of improving competitiveness.<sup>184</sup>

As a renewable materials company that minimises waste, Stora Enso operates at the heart of the bioeconomy and contributes to a circular economy. Sustainable forest management secures the availability of company’s renewable resources, protects biodiversity, and helps combat global warming.<sup>185</sup>

Stora Enso proactively responds to global megatrends such as global warming, population growth, eco-awareness, and urbanisation affecting consumer and corporate decision-making around the world by developing products and solutions based on materials that are both

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<sup>178</sup> Stora Enso operates in: Finland, Sweden, China, Austria, Baltic countries, Belgium, Brazil, Czech Republic, Germany, Netherlands, Poland, Russia, Uruguay, USA. More information available at: <https://www.storaenso.com/en/about-stora-enso/stora-enso-locations> (Accessed July 10th 2020).

<sup>179</sup> See at <https://www.upm.com/about-us/vision-and-purpose/> (Accessed 10th July 2020).

<sup>180</sup> See at <https://www.storaenso.com/en/about-stora-enso/our-purpose-and-values> (Accessed July 10th 2020).

<sup>181</sup> See at <https://www.upm.com/responsibility/circulareconomy/> (Accessed 10th July 2020).

<sup>182</sup> Ibid.

<sup>183</sup> Ibid.

<sup>184</sup> Ibid.

<sup>185</sup> See at <https://www.storaenso.com/en/sustainability/environmental> (Accessed 10th July 2020).

renewable and recyclable.<sup>186</sup> Replacing the use of fossil-based resources with renewable raw materials is perceived as the foundation for a sustainable bioeconomy.<sup>187</sup>

As we see minimizing waste, reusing it as raw material or energy, development of renewable and recyclable materials and their effective use are the major aspects of both companies circular economy agenda. It is worth examining how it is presented in companies' disclosure papers and what measures are taken to ensure those voluntary standards. The focus for examination will be waste prevention and management.

### **3.3. UPM and Stora Enso. Voluntary Standards. Waste Prevention and Management Focus**

#### **3.3.1. UPM Voluntary Standards**

##### **3.3.1.(a) Environmental Target (Focus Area) “Waste”**

UPM responsibility focus areas are divided into economic, social and environmental responsibility. For each responsibility focus area targets and key performance indicators have been determined.<sup>188</sup> Environmental responsibility covers sustainable products, climate and use of forests, as well as water and waste reduction.<sup>189</sup>

UPM focus areas and targets are reviewed annually based on a materiality analysis, which identifies issues that either have a significant impact on the company's business performance or issues that influence the assessment and decisions made by the stakeholders.<sup>190</sup>

For the relevance to this research we are to concentrate on the Environmental Target (Focus Area) “Waste”. The latter sets a target of promoting material efficiency and circular economy - reduce, reuse and recycle.<sup>191</sup> Under the target UPM will not deposit any process waste

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<sup>186</sup> See at <https://www.storaenso.com/en/sustainability/environmental/materials-water-and-energy> (Accessed 10th July 2020).

<sup>187</sup> See at <https://www.storaenso.com/en/sustainability/environmental/materials-water-and-energy> (Accessed 10th July 2020).

<sup>188</sup> UPM Annual Report 2018, p. 26.  
Available at [https://www.upm.com/siteassets/asset/investors/2018/upm\\_ar18\\_en\\_190227\\_web\\_secured.pdf](https://www.upm.com/siteassets/asset/investors/2018/upm_ar18_en_190227_web_secured.pdf) (Accessed 3d May 2020).

<sup>189</sup> UPM Corporate Environmental and Societal Responsibility Statement 2018, p.9. Available at [https://www.upm.com/siteassets/documents/responsibility/1-fundamentals/emas-reports/pulp-and-paper-mill-specific-emas-statements/2018/upm\\_global\\_emas\\_2018\\_en.pdf](https://www.upm.com/siteassets/documents/responsibility/1-fundamentals/emas-reports/pulp-and-paper-mill-specific-emas-statements/2018/upm_global_emas_2018_en.pdf) (Accessed 3d May 2020); UPM Annual Report 2018, p. 26; UPM Annual Report 2019, p. 132.

<sup>190</sup> UPM Corporate Environmental and Societal Responsibility Statement 2018, p.9; UPM Annual Report 2018, p. 26, Annual Report 2019, p. 132.

<sup>191</sup> UPM Annual Report 2018, p. 26-27.

at landfill sites, and no process waste will be incinerated without energy recovery by 2030.<sup>192</sup> Hence UPM has a target to become a Zero Solid Waste to Landfill company globally by 2030.

While paying special attention to the focus area “Waste” UPM considers both: the main environmental impact (use of landfill sites and municipal waste incineration plants) and indirect environmental impact (by third-parties for waste recycling and recovery, e.g. pollution due to inappropriate handling and storage).<sup>193</sup> Therefore, landfill sites for depositing solid waste account for the most significant environmental impact in waste management. The environmental impacts of UPM landfill sites are being monitored in accordance with permits and regulations issued by the relevant authorities.<sup>194</sup> Company is aimed at increasing or maintaining high recovery quota by following the principle “reduce, reuse and recycle”. In respect of indirect environmental impact such measures as third-party/supplier qualification, audits are practiced.<sup>195</sup>

All UPM’s mills have made efforts to reduce the volume of solid waste and to improve handling by sorting the waste at source. A large part of the process waste is utilized either as raw material or in energy generation. The volume of solid waste taken to landfill sites has decreased significantly over the past years as a result of higher efficiency in production processes and increased opportunities for reuse.<sup>196</sup> UPM has developed innovative ways to reduce its own waste and to recycle waste or residues with new products.<sup>197</sup>

### **3.3.1.(b) Contribution to SDG 12**

UPM contributes to SDGs. The SDGs where the company has the most negative impact or those where it can contribute most positively have been identified.<sup>198</sup> In the Annual Report 2019 contribution to SDGs is described this way: “Our responsibility targets contribute positively to SDGs”.<sup>199</sup> In 2019, UPM reviewed all 17 SDGs and their 169 targets against company’s operating environment. The most relevant SDG targets were chosen based on where UPM can have the largest impact, either by minimizing negative impacts or by increasing the positive impacts. Others SDGs, in UPM’s view are also relevant, but to a lesser extent.”<sup>200</sup>

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<sup>192</sup> UPM Corporate Environmental and Societal Responsibility Statement, p. 37.

<sup>193</sup> Ibid, p. 34.

<sup>194</sup> Ibid, p. 37.

<sup>195</sup> Ibid, p. 34.

<sup>196</sup> Ibid, p. 37.

<sup>197</sup> For instance, UPM BioVerno, UPM’s renewable diesel and naphtha, as well as UPM ProFi composite, which partly utilises waste from the production of self-adhesive label materials.

<sup>198</sup> Under the UPM Annual Report 2018 those SDGs to address were: SDGs 3,8,9,12,13 and 15 (Annual Report 2018 p.26-27), revised in 2019 and set as: SDGs 6, 7, 8, 12, 13, 15.

<sup>199</sup> UPM Annual Report 2019, p. 60.

<sup>200</sup> Ibid.

After having analysed and evaluated the outcome with businesses, 12 targets for 6 SDGs were chosen as the focus of UPM's work.<sup>201</sup> Company continuously monitors the progress of its contribution to SDGs and raises the bar when targets are reached ahead of schedule or when new or more ambitious targets are needed to meet the needs of the changing world.<sup>202</sup> Those most relevant SDGs for UPM are aligned with the responsibility focus areas.<sup>203</sup> In context of circular economy contribution to SDG 12 "Responsible Consumption and Production" (target 12.5) is emphasized.<sup>204</sup> Concrete examples of contribution and solutions towards circular economy taken with regard to SDG 12 are given in the Annual Report 2019.<sup>205</sup>

Since 2003, UPM is a signatory of the UN Global Compact initiative, whose ten universal principles are derived from international agreements in the areas of human rights, labour standards, the environment and anti-corruption. And since 2016, UPM has the LEAD participant status for its commitment to the UN Global Compact.<sup>206</sup> UPM follows the Global Reporting Initiative's (GRI) Sustainability Reporting Standards in its corporate responsibility reporting.<sup>207</sup>

### **3.3.1.(c) Values Promotion through the Supply Chain**

The third and the last standard to address is the way targets and high goals mentioned above though being voluntary are insured within the company and supply chain. Two major tools are Code of Conduct and Supplier and Third Party Code.<sup>208</sup> The UPM Code of Conduct has been updated in 2019. The launch of the updated Code of Conduct was followed by extensive communication and training efforts to enhance employees' awareness and understanding of its contents.<sup>209</sup>

<sup>201</sup> The chosen SDGs are: SDG 6 (Clean water and sanitation), SDG 7 (Affordable and clean energy), SDG 8 (Decent work and economic growth), SDG 12 (Responsible consumption and production), SDG 13 (Climate action) and SDG 15 (Life on land). See UPM Annual Report 2019, p.25.

<sup>202</sup> UPM Annual Report 2019, p.25.

<sup>203</sup> UPM Corporate Environmental and Societal Responsibility Statement 2018, p. 9.

<sup>204</sup> UPM Annual Report 2018, pp. 26-27, UPM Corporate Environmental and Societal Responsibility Statement 2018, p. 9.

<sup>205</sup> UPM Annual Report 2019, p.96.

<sup>206</sup> UPM Annual Report 2019, p.132.

<sup>207</sup> The reporting is prepared in accordance with the GRI Standards: Core option. UPM's GRI index document shows where the disclosures of material topics and general disclosures are addressed in the Annual Report, on UPM's webpage or in the GRI index document itself. It also includes information on omissions, additional explanations and disclosures on the management approach. See UPM Annual Report 2019, p.116.

<sup>208</sup> UPM Code of Conduct; UPM Supplier and Third Party Code. Available at <https://www.upm.com/siteassets/documents/for-suppliers/upm-supplier-and-third-party-code.pdf> (Accessed 3d May 2020).

<sup>209</sup> UPM Annual Report 2019, p.132.

The UPM Code of Conduct emphasizes UPM's commitment to business integrity and responsible business operations, manifesting the company's guiding principles.<sup>210</sup> The Code of Conduct is complemented by more detailed policies approved by the Board of Directors and rules approved by the Group Executive Team, business areas or global functions.<sup>211</sup> These policies and rules cover among others such topic as the environment.<sup>212</sup>

Regarding environmental responsibility agenda and waste management, prevention in particular UPM's employees are required:

- to be aware of the environmental impacts and legal requirements of the work and workplace;
- to avoid unnecessary risks and act before there is a problem;
- to share the best practices with others;
- to perform all measurements, analyses and reporting truthfully and accurately;
- not to waste resources (water, energy, raw materials) and use them efficiently;
- to handle chemicals and all waste with care and according to instructions;
- to report any activities that might pose a risk to the environment;
- to make sure that products meet their requirements.<sup>213</sup>

The UPM is committed to responsible sourcing practices in the company's Code of Conduct. UPM requires its suppliers, third party intermediaries and joint venture partners to apply the same principles as in the UPM Code of Conduct and to fulfil criteria concerning social and environmental responsibility. These requirements are defined in the UPM Supplier and Third Party Code.<sup>214</sup> The UPM Supplier and Third-Party Code was revised to reflect the changes in the Code of Conduct.<sup>215</sup>

According to the company's vision, having responsible practices in the supply chain creates long-term value for UPM and its stakeholders. The UPM Supplier and Third-Party Code sets transparent requirements for the entire supply chain and has focus on 2030 responsibility targets.<sup>216</sup> UPM's Supplier and Third-Party Code defines the minimum level of performance that UPM requires from all its suppliers and third parties and there are additional requirements for certain materials and services.<sup>217</sup> When UPM sets requirements for suppliers, it expects them to

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<sup>210</sup> Ibid.

<sup>211</sup> Ibid.

<sup>212</sup> Ibid.

<sup>213</sup> UPM Code of Conduct, p. 9.

<sup>214</sup> UPM Annual Report 2019, p.132.

<sup>215</sup> UPM Annual Report 2019, p.25.

<sup>216</sup> UPM Annual Report 2018, p.60.

<sup>217</sup> UPM Supplier and Third Party Code, p.3.

take these requirements further in their supply chains and promote the requirements described in this Supplier and Third-Party Code or similar standards to other parties in their supply chain.<sup>218</sup>

As long as UPM requires that the suppliers promote the same requirements in their own supply chains, all new suppliers are evaluated, thus, UPM carries out supplier risk assessments.<sup>219</sup> The responsibility-related risks are determined by the country of origin, sourced material and complexity of supply chain. Based on the risk assessment, selected suppliers' activities are evaluated in more detail through annual surveys, supplier audits and joint development plans.<sup>220</sup>

Regarding environmental responsibility agenda and waste management, prevention in particular UPM's suppliers are required:

- to be aware of the environmental impacts and legal requirements of their work and workplace;
- not to waste resources (water, energy, raw materials) and use them efficiently;
- to report any activities that might pose a risk to the environment;
- to make sure that products meet their requirements.<sup>221</sup>

The UPM Supplier or Third-Party needs to: minimise their negative environmental impact on land, water, biodiversity, climate, and air; manage any waste according to applicable laws and the manufacturer's instructions; ensure that its products are safe for the use they are meant for.

UPM requires to set up and maintain procedures that ensure suppliers or third parties comply with their waste management obligations. UPM emphasizes that it is important always to look for opportunities to reduce and reuse the waste from suppliers' (or their parties') operations or from products, or customers' assets. It should be ensured that hazardous waste is treated according to applicable legislation and manufacturer's instructions.<sup>222</sup>

UPM will consider a violation of laws or the Supplier and Third-Party Code or a failure to take corrective action a breach of contract, and this may entitle UPM to terminate the business relationship with the supplier or third-party.<sup>223</sup>

### **3.3.2. Stora Enso Voluntary Standards**

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<sup>218</sup> UPM Practical Guide to Everyday Decision, p.20.

<sup>219</sup> In 2019, UPM enhanced its supplier screening and risk mitigation; new counterparty risk management tool offers better visibility into counterparty-related risks through automated screening and support businesses in ethical and preventive decision-making.<sup>219</sup> In 2019, 84% (83%) of UPM total spend was qualified against the UPM Supplier and Third Party Code.<sup>219</sup> In 2018 this figure was 83% (82%). See UPM Annual Report 2018, p.60.

<sup>220</sup> UPM Annual Report 2019, p.81.

<sup>221</sup> UPM Code of Conduct, p. 9.

<sup>222</sup> UPM Practical Guide to Everyday Decision, p.11.

<sup>223</sup> UPM Supplier and Third Party Code, p. 3.

### **3.3.2.(a) Key Performance Indicator “Materials, Water and Energy”**

Stora Enso’s sustainability agenda encompasses the social, environmental, and economic responsibility of operations throughout the value chain. It addresses the ten sustainability topics identified as material to Stora Enso and its key stakeholders: employees and wider workforce; community; business ethics; materials, water, and energy; carbon dioxide; forests, plantations, and land use; customers; suppliers; and investors.<sup>224</sup>

In line with the agenda, targets have been set and key performance indicators (KPIs) defined for Stora Enso’s sustainability work. Progress is regularly monitored at Group level and via division-level business reviews. Consolidated results on the performance are reported annually in the Sustainability report. Selected sustainability indicators are also reported quarterly in the Interim Reports.<sup>225</sup>

With the relevance to this research we are to concentrate on KPI “Materials, Water and Energy”, where “Materials” are linked to “Process residuals utilisation rate”. Up to date the target to maintain the high utilisation rate of 98% has been achieved.<sup>226</sup>

Under Stora Enso’s vision contributing to the circular bioeconomy company helps its customers become circular: company’s products are renewable, recyclable, and in many cases compostable. Waste and resource use are minimized and Stora Enso aims to maintain the value of products and materials for as long as possible through product design, innovation, and recycling. When a material or product has reached its end-of-life, company promotes recycling and energy recovery to create further value.<sup>227</sup>

Stora Enso is a signatory to the New Plastics Economy Global Commitment led by the Ellen MacArthur Foundation, in collaboration with UN Environment. In 2019, company’s progress was disclosed in the Ellen MacArthur Foundation’s Global Commitment Progress Report. As a founding board member of WBCSD’s circular economy initiative, Factor10, Stora Enso worked to develop the ‘CEO Guide to Circular Bioeconomy’ publication.<sup>228</sup>

In 2019, Stora Enso as a member of Confederation of European Paper Industries (CEPI) launched the forevergreen alliance to promote fiber-based packaging across the value chain.<sup>229</sup>

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<sup>224</sup> Stora Enso Annual Report 2019, Sustainability, p.5. Available at <https://annual-report.storaenso.com/2019> (Accessed 3d May 2020).

<sup>225</sup> Ibid, p.5.

<sup>226</sup> Ibid, p.9.

<sup>227</sup> Ibid, p.34.

<sup>228</sup> Ibid.

<sup>229</sup> Ibid.

Stora Enso constantly innovates to improve resource efficiency and make profitable use of material streams that would otherwise end up as waste. Company aims to maximise the value of material streams and work towards zero process waste. That is seen to be achieved through circular material flows in Stora Enso's value chain, while reducing own process waste to landfill to as close to zero whenever legally, technically and commercially possible.<sup>230</sup> The Group target is to maintain the high level of a 98% process residuals utilisation rate. The target covers all Stora Enso production units.<sup>231</sup> Detailed examples of circularity can be found in company's Annual Report 2019.<sup>232</sup>

### **3.3.2.(b) Contribution to SDG 12**

Stora Enso acknowledges the importance of the UN SDGs as part of a commonly agreed global ambition to end poverty, protect the planet, and improve the lives and prospects of everyone, everywhere.<sup>233</sup> SDGs are integrated into company's strategy. In 2016, Stora Enso investigated how its business operations relate to the SDGs, based on previous materiality reviews, risk assessments, and stakeholder consultations.

In 2017, an external expert organization engaged with company's divisions and functions to prioritise the SDGs according to their relevance to the operations, and assess company's impacts and related business opportunities. The outcomes were reviewed by Stora Enso's CEO and Group Leadership Team (GLT).<sup>234</sup> In 2018, the GLT confirmed the SDGs most strategic to Stora Enso's business. Company also decided to work on new 2030 sustainability targets that are aligned with Stora Enso's contribution to the prioritised SDGs.<sup>235</sup>

During 2019 year Stora Enso also participated in the development of the SDG Sector Roadmap as part of co-chairing of the Forest Solutions Group (FSG) at the World Business Council for Sustainable Development (WBCSD). The roadmap describes the forestry sector's current level of alignment with the SDGs, and identifies the key impact opportunities and actions that the sector should take. Company's way of working is in line with the SDG Compass, which was developed by the Global Reporting Initiative (GRI), the UN Global Compact (UNGC), and WBCSD as a guide for companies.<sup>236</sup>

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<sup>230</sup> Ibid.

<sup>231</sup> Ibid.

<sup>232</sup> Ibid, p.37.

<sup>233</sup> Ibid, p.5.

<sup>234</sup> Stora Enso Annual Report 2018, Sustainability, p.10. Available at [https://www.storaenso.com/-/media/documents/download-center/documents/annual-reports/2018/storaenso\\_annual\\_report\\_2018.pdf](https://www.storaenso.com/-/media/documents/download-center/documents/annual-reports/2018/storaenso_annual_report_2018.pdf) (Accessed 3d May 2020); Stora Enso Annual Report 2019, Sustainability, p.10.

<sup>235</sup> Stora Enso Annual Report 2018, Sustainability, p.10, Stora Enso Annual Report 2019, Sustainability, p.10.

<sup>236</sup> Ibid.



Stora Enso defined its key impacts in relation to its most strategic SDGs: SDG 12, 13 and 15. In more details reporting to the SDG sub-targets is explained in a separate document.<sup>237</sup>

Company's contribution and business opportunities related to SDG 12 (Responsible consumption and production) can be summarised by the concepts of circular economy and bioeconomy. Current key Group sustainability target in relation to SDG 12 drives the utilisation of process residuals and waste at Stora Enso's production units, as measured as a process residuals utilisation rate.<sup>238</sup> Stora Enso reports on its contributions to the sub-targets of priority SDGs, including SDG 12.<sup>239</sup>

### **3.3.2.(c) Values Promotion through the Supply Chain**

Stora Enso provides guidance regarding company's policies relevant to use of materials, water, and energy throughout the supply chain with the use of the Stora Enso Code (guides on issues related to resource use), Supplier Code of Conduct (includes practical instructions for Stora Enso's suppliers) and Purchasers' Instructions, Sourcing Policy, and Sourcing Guidelines: a guiding framework for the responsible sourcing of materials and energy.<sup>240</sup>

As a global business with over 20 000 suppliers globally, Stora Enso can use its purchasing power to drive them to make their operations more sustainable. This helps to increase the number of suppliers with improved sustainability globally.<sup>241</sup> However, developing a comprehensive understanding of a supplier's sustainability performance remains a challenge, even with very strict sourcing processes and criteria in place. By passing on sustainability requirements to its direct suppliers, Stora Enso is able to drive positive change further down its supply chains.<sup>242</sup>

The Stora Enso Code, known also as Code of Conduct, gives the tools to make the right decisions in work while promoting transparency, ethics, and sustainability.<sup>243</sup> Regarding the focus of this study it is worth paying attention at a number of duties under the Code of conduct, those are:

- always conduct careful due diligence before selecting a business partner;<sup>244</sup>

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<sup>237</sup> Ibid.

<sup>238</sup> Ibid.

<sup>239</sup> See more about sub-target level at [https://www.storaenso.com/-/media/Documents/Download-center/Documents/Annual-reports/2019/STORAENSO\\_SDG\\_2019.pdf](https://www.storaenso.com/-/media/Documents/Download-center/Documents/Annual-reports/2019/STORAENSO_SDG_2019.pdf) (Accessed 10th July 2020).

<sup>240</sup> Stora Enso Annual Report 2019, Sustainability, p.32.

<sup>241</sup> Ibid, p.60.

<sup>242</sup> Ibid.

<sup>243</sup> Stora Enso Code of Conduct.

<sup>244</sup> Stora Enso Code of Conduct, p.9.

- use resources efficiently and reuse and recycle materials whenever possible to minimise waste;
- choose renewable materials over non-renewable materials whenever possible.<sup>245</sup>

Stora Enso complies with all applicable local, national, and international laws, regulations, and voluntary commitments wherever it does business.<sup>246</sup> It is emphasized to be of utmost importance to be aware of and adhere to all laws and regulations that apply to the work – including company’s policies.<sup>247</sup> Where local laws or regulations differ from the Stora Enso Code, it must be ensured that both standards are met. Company is aimed at going beyond compliance whenever possible and always strives to be better. It also requires all agents, consultants, and business partners who work on Stora Enso’s behalf to comply with these same laws and practices, including Stora Enso’s Supplier Code of Conduct.<sup>248</sup>

The Stora Enso Supplier Code of Conduct (SCoC) is the cornerstone of its approach to responsible sourcing. It is a legally binding document that imposes sustainability requirements on the suppliers concerning human and labour rights, occupational health and safety, environmental commitments, and responsible business practices. The SCoC applies to all company’s sourcing categories globally.<sup>249</sup>

In 2019, Stora Enso created new guidelines, with sustainability considerations embedded, for strengthening the role of sourcing categories in managing company’s activities.<sup>250</sup> Company uses sustainability criteria in the tendering phase of all sourcing, regardless of previous contracts with the same supplier, and collects data on supplier performance. The criteria help to make more balanced sourcing decisions and create incentives for suppliers to invest in sustainability reporting.<sup>251</sup>

Stora Enso’s supplier sustainability risk mapping tool, created in collaboration with an international non-profit organisation, helps purchasers to make more detailed risk assessments. Based on a pre-evaluation of a supplier’s social and environmental risk profile, they may be selected for a third-party sustainability audit, conducted together with the purchaser.<sup>252</sup>

Any suspected SCoC non-conformances identified during supplier visits or audits or brought to attention through many grievance channels are duly investigated. The findings are discussed, and corrective action plans are devised together with suppliers that must sign up to the

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<sup>245</sup> Stora Enso Code of Conduct, p.14.

<sup>246</sup> Ibid, p.7.

<sup>247</sup> Ibid.

<sup>248</sup> Ibid.

<sup>249</sup> Stora Enso Annual Report 2019, p.60.

<sup>250</sup> Ibid, p.61.

<sup>251</sup> Ibid.

<sup>252</sup> Ibid.

plans. Purchasers follow up on their implementation.<sup>253</sup> If a supplier does not take the necessary corrective actions, new discussions are held to examine the reasons, and at a higher management level if necessary. In cases when a supplier is not willing to improve their performance, the relationship is terminated.<sup>254</sup> Stora Enso reserves the right to cancel outstanding orders, suspend future orders or terminate the contract with the Suppliers in case of a material breach of the CoC.<sup>255</sup>

Stora Enso also encourages suppliers' senior management to take responsibility for the performance on Code of Conduct issues, and to review the performance regularly to ensure that targets are reached and improvements are made.<sup>256</sup> The Supplier is liable for the performance of its sub-suppliers as for its own work. The Supplier shall duly ensure and monitor that its own suppliers and sub-suppliers comply with this SCoC or their own equivalent code of conduct.<sup>257</sup>

Regarding waste and recycling agenda, Stora Enso aims to ensure that its operations and products have superior environmental performance throughout their life cycles, and expects its business partners and suppliers to do the same.<sup>258</sup> Stora Enso's Ultimate "Vision Zero" of a company with no waste-to-landfill, no harmful air emissions, and no wastewater discharges is very challenging, but it nevertheless helps to take steps in the right direction through continuous improvements and reduced environmental impacts, also along the supply chain.<sup>259</sup>

Under the Practical Guide for Stora Enso's Suppliers, effective ways to systematically reduce environmental impacts are covered.<sup>260</sup> With regard to managing wastes and residuals Stora Enso requires suppliers to:

- avoid misunderstandings when dispose, reuse and recycle of these materials;
- avoid the mixing of waste that would be recyclable;
- ensure that all hazardous wastes are safely stored and that you contract licensed suppliers for their transportation and final treatment;
- make sure you have an effective traceability system for all your waste;
- keep good records of the amounts of waste and residuals you generate, and monitor the related trends.<sup>261</sup>

### 3.4. Conclusion

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<sup>253</sup> Stora Enso Annual Report 2019, p.61.

<sup>254</sup> Ibid.

<sup>255</sup> Stora Enso Supplier Code of Conduct, p.3.

<sup>256</sup> Ibid, p. 2.

<sup>257</sup> Ibid, p.1.

<sup>258</sup> Practical Guide for Stora Enso's Suppliers p. 10.

<sup>259</sup> Ibid.

<sup>260</sup> Ibid.

<sup>261</sup> Ibid, p. 12.

Voluntary commitments of two companies UPM and Stora Enso towards shift to circular economy and its waste prevention and management dimension were the objects of this chapter examination. It is possible to conclude that companies have high ambition, want to be on driver's seat and show example to peers. Minimizing waste, reusing it as raw material or energy, development of renewable and recyclable materials and their effective use are the cornerstones of both companies' circular economy agenda. Companies pay close attention to the latter, reporting constantly and profoundly on the matter and show willingness to go beyond mere compliance with circular economy law.

Three voluntary standards were presented in details and can be summarized in short as follows: companies 1) set ambitious environmental targets (minimizing waste through recycling or utilization either as raw material or by energy recovery, aiming at zero waste to landfill target); 2) show willingness to contribute to SDG 12; 3) promote values of sustainability and waste minimization while going beyond mere compliance with binding laws throughout the supply chain.

The investigated data brings us to a conclusion that despite the fact companies use different language and techniques to describe their voluntary standards of waste prevention and management the latter are still similar and follow the same logic in both: substantive and procedural dimension (enforcement and monitoring). That might mean that voluntary standards are not created chaotically and companies (especially competitors in the same industry field – like those two we examined) tend to stick to a single line and, therefore, are in great need of “level playing field” regulatory environment.

However, the studied material also clearly shows that due to the lack of common standards in law, companies refer to diversity of voluntary standards offered by international sustainability-related initiatives and, therefore, the possible voluntary assurance techniques might differ much as well.

Despite the strong and promising power of volunteerism, there are still fields that it can't cover without assistance of law (its binding nature and enforceability tools). The matters of unrest when one is to assess the potential power of voluntary standards aimed at shift to circular economy are almost the same that surround voluntary sustainability commitments in general. Those to be named are:

- diversity of standards companies are referring to (even two companies analysis shows the diversity of global voluntary initiatives they are contributing to) and lack of external

audit (“only limited assurance can be given”<sup>262</sup>, “lack of means for comparison over time and among companies”<sup>263</sup>);

- supply chain limitation (while set values and targets are promoted and ensured within the value chain through such tools as Codes of Conduct; demand (in case companies change their contract role to being suppliers themselves) and finance chain are not largely involved);
- lack of remedies, enforceability mechanisms (as voluntary commitments are not by their nature binding and do not have power of law).

Big international companies, such as those presented in the chapter, are working much on enhancing their volunteerism and overcoming the mentioned drawbacks. However, even for such strongly motivated and fair business actors there is still serious matter to consider regarding sustainable shift to circular economy. The latter may be associated with changing of business roles and presenting contracting opportunities of being on supply side. In the previous chapter dedicated to circular economy law, analysis of German and Finnish waste prevention policies oriented on business showed that new forms of cooperation between companies are promoted. In such situation creating of “level playing field” and eliminating of the drawbacks mentioned above will play a crucial role.

More to that, it is hard to ensure fair competition even for front runner companies. While the latter tend to be as transparent as possible not only about their efforts but also challenges they face while making a shift towards circular economy, other companies have an opportunity just to try to “project a positive image of their sustainability efforts (cherry picking)”<sup>264</sup> or even practice greenwashing and SDG washing. In other words, if the information disclosed is relevant and reliable, this will be beneficial, but there is no assurance, that this will be the case.<sup>265</sup>

Those major problems mentioned can be solved only with the assistance of law. In the previous chapter we have discovered that the power of circular economy law is limited. To what extent company law in its current state of the art can assist companies will be examined in the next two chapters.

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<sup>262</sup> Fagerström, Arne - Cunningham, Gary: Accounting and Auditing of Sustainability, Sustainable Indicator Accounting, SIA, 2016, p.45.

<sup>263</sup> Ibid.

<sup>264</sup> Ibid.

<sup>265</sup> Clarke, Blanaid - Anker-Sørensen, Linn: The EU as a Potential Norm Creator for Sustainable Corporate Groups in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 14, p.202.

## 4. COMPANY LAW

In the previous chapters we overviewed circular economy law core concepts and examined related to circular economy companies' voluntary standards with the waste prevention and management focus. In the chapter dedicated to circular economy law we looked at the basic concepts of the Waste Framework Directive related to the waste prevention and management in companies. We discovered that policymakers in both Germany and Finland when it comes to waste management and prevention on behalf of business tend to rely on business advice and initiative more than apply strict and command top-down approach. Regarding end-of-waste status and precautionary principle we through the study of the recent CJEU case law discovered that both concepts are too unprecise and are to be assessed on the Member State level on a case-by-case basis. Therefore, attitude in Finland and Germany may differ. That means companies can't rely on these concepts in full. Their interpretation is not harmonized enough and develops too slow.

Analysis of UPM's and Stora Enso's voluntary standards brought us to conclusion that companies pay much attention to circular economy and waste agenda standards within their sustainability strategies and report much on the matter. They set high goals beyond compliance with regulation, act to contribute to SDG 12 and promote those values through the supply chain using such tools as Codes of Conduct and Suppliers Codes. It may be concluded, that companies indeed have willingness to be front runners and show example to others. The latter correlates with the policies' tendency in Member States we discovered previously: to rely on business example, to learn from business effective practices. Nevertheless it is important to be aware of the fact that voluntary standards and their disclosure are of non-financial nature and do not have legal mechanisms of external audit or enforcement, except voluntary participation of companies in such initiatives like UN Global Compact, for instance. Moreover, companies' potential to enhance circular economy and promote waste prevention is also limited because of the downsides of circular economy concepts, that we named previously, mostly lack of the latter's harmonized interpretation and slow development.

In this chapter we will address core company law concepts that are at the center of companies' decision-making process and therefore reflect companies' contribution to sustainability and circular economy in particular. We will look at the EU and Finland, Germany levels regarding purpose of company and duties of board in limited liability companies acts and then analyze the Corporate Governance Codes of Germany and Finland regarding sustainability narrative. The investigation will be aimed at understanding the recent state-of-the art of company

law in correlation with sustainability agenda, whether it is enough to ensure sustainable shift towards circular economy to business.

#### **4.1. Companies Acts. EU, Finland and Germany**

##### **4.1.1. European Union**

It is observed by B. Sjøfjell, J. Mähönen, T. Novitz, C. Gammage, and H. Ahlström that sustainability is an overarching objective of the EU and meant to be guiding principle for the EU's policies and activities.<sup>266</sup> European Union commitment to sustainability is reflected in the EU Treaties.<sup>267</sup> The subsidiary principle of the EU, however, entails that it shall only act if action on an EU level is necessary.<sup>268</sup> Company law scholars assume both ways of addressing sustainability agenda: through national and EU company law reforms.

For instance, J. Mähönen and B. Sjøfjell consider Nordic corporate law reform to push companies to pursue sustainable value a competitive advantage taking into account strong sides of the Nordic countries' corporate law, such as its flexibility, commitment of the important private long-term investors and the sustainability concerns of public market actors.<sup>269</sup> Andreas Rühmkorf, observing purpose of company in German company law context, makes a conclusion that 'the current law does not do much to encourage board members to pursue the different dimensions of sustainability in their decisions'<sup>270</sup> and legislator should therefore also take a step further and include 'sustainable value creation' with a content that resonates with the grand

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<sup>266</sup> Sjøfjell, B. - Mähönen, J. - Novitz, T. - Gammage, C. - Ahlström, H.: Securing the future of European business: SMART reform proposals, SMART Report (2020), p. 5.

<sup>267</sup> Treaty on the European Union (TEU) Article 3(3) and 3(5), Article 11 of Treaty on the Functioning of the European Union (TFEU) requires the implementation of environmental protection requirements in all EU policies where necessary to achieve sustainability (environmental integration rule). Policy coherence for development is set out as an EU legal norm in Article 208 TFEU, requiring that any area of EU law and policy must not work against developmental policies, also with sustainability aim of "leaving no-one behind". See Sjøfjell, B. - Mähönen, J. - Novitz, T. - Gammage, C. - Ahlström, H.: Securing the future of European business: SMART reform proposals, SMART Report (2020).

<sup>268</sup> The subsidiarity principle of the EU entails that in areas where the EU does not have exclusive competence, it may only act when the objectives of an action cannot be sufficiently achieved by the Member States, but can be better achieved at the EU level, 'by reason of the scale and effects of the proposed action'. Under the principle of proportionality, the 'content and form' of EU action shall not 'exceed what is necessary to achieve the objectives of the Treaties. See Articles 3(5), 3(4) TEU and Sjøfjell, B. - Mähönen, J. - Novitz, T. - Gammage, C. - Ahlström, H.: Securing the future of European business: SMART reform proposals, SMART Report (2020), p.27.

<sup>269</sup> Sjøfjell, Beate - Mähönen, Jukka T.: Upgrading the Nordic Corporate Governance Model for Sustainable Companies, European Company Law, 2014, Volume 11, Issue 2. p.58. Developed further in the EU-funded project Sustainable Market Actors for Responsible Trade (SMART), 2016–2020, see [www.smart.uio.no](http://www.smart.uio.no) (Accessed 15th July 2020).

<sup>270</sup> Rühmkorf, Andreas: Stakeholder value versus Corporate Sustainability in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 17, p. 245.

challenges of our time.<sup>271</sup> Moreover, individual initiatives by Member States can be inspiring examples and also stimulate EU action: for instance, initiatives such as the French vigilance law are sound.<sup>272</sup>

There is also an opinion, that transnational nature of business and its unsustainability makes it clear that action on the EU level indeed is necessary.<sup>273</sup> M.B. Taylor and M. van der Velden fairly point out that the EU directives will apply in all Member States, and may enshrine progressive norms.<sup>274</sup> Supposedly, in the nowadays scenario EU indeed is more likely to take the leading role and a major reform of corporate law may start on the Union level, with Member States to follow. This expectation is based on the following assumptions.

The recent EU regulation on company law is based on Article 50 of the TFEU. This article does not set other limitations to the type, purpose or size of the undertaking except excluding entities with pure non-profit purpose.<sup>275</sup> One of the major pieces of the EU legislation to mention in the context of this research is the Company Law Directive 2017.<sup>276</sup> The Directive, however, does not formulate on the EU level any rules regarding the purpose of the company and duties of the board dedicated to sustainability. Hence, it may be concluded that on the EU level core legislative norms of company law remain silent about environmental sustainability agenda. The exception is requirement to report environmental (and employee) matters.<sup>277</sup>

Indeed, up to the present day on the EU level, there has been no attempt to impose legal obligations on corporations that would radically depart from corporate governance traditions, but the EU is seeking to articulate an emerging normative consensus on the obligations of business with respect to the environment.<sup>278</sup> The EU, for instance, does not stay aside from the global trend towards corporate sustainability; moreover, it “has sought to demonstrate some degree of leadership in the area of sustainable corporate conduct and, recognizing its importance, has

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<sup>271</sup> Ibid.

<sup>272</sup> See Magnier, Véronique: Old-Fashioned Yet Innovative: Corporate Law, Corporate Governance and Sustainability in France in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 20, pp. 276-289.

<sup>273</sup> Sjøfjell, B. - Mähönen, J. - Novitz, T. - Gammage, C. - Ahlström, H.: Securing the future of European business: SMART reform proposals, SMART Report (2020), p. 25.

<sup>274</sup> Taylor, M.B. - van der Velden, M.: Resistance to Regulation: Failing Sustainability in Product Lifecycles, Sustainability 2019, 11, 6526, p.6.

<sup>275</sup> See more: Sjøfjell, B. - Mähönen, J. - Novitz, T. - Gammage, C. - Ahlström, H.: Securing the future of European business: SMART reform proposals, SMART Report (2020).

<sup>276</sup> Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (OJ L 169, 30.6.2017, p. 46).

<sup>277</sup> Millon, David K.: Corporate Social Responsibility and Environmental Sustainability in Company Law and Sustainability: Legal Barriers and Opportunities, Beate Sjøfjell and Benjamin J. Richardson (eds.), Cambridge University Press, 2015, p.51

<sup>278</sup> Ibid, 52.



introduced a number of targeted initiatives focused on increased disclosure”.<sup>279</sup> In this respect, encouragement from the EU, though still essentially hortatory, parallels traditions of the relatively robust and ambitious top-down exercise of state authority addressing a broad range of social problems.<sup>280</sup>

Retrospectively, EU’s efforts to integrate sustainability into business activities were largely based on the concept of Corporate Social Responsibility (CSR). In the domain of corporate law, the concept of CSR has served as the nexus for discussing the societal expectations of companies’ social and environmental impact and performance.<sup>281</sup> The European Commission has emphasized that an effective sustainable development strategy “must integrate economic, social and environmental sustainability”.<sup>282</sup> Through various policy documents and secondary legislation, the Commission has created minimum standards in terms of sustainable corporate conduct.<sup>283</sup>

The 2001 Commission Green Paper, Promoting a European framework for Corporate Social Responsibility defined CSR as a ‘concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment’.<sup>284</sup> It acknowledged that while the prime responsibility of a company is generating profits, companies could simultaneously “contribute to social and environmental objectives, through integrating [CSR] as a strategic investment into their core business strategy, their management instruments and their operations”.<sup>285</sup>

In its 2011 communication, a renewed EU strategy 2011-14 for Corporate Social Responsibility, the Commission acknowledged that addressing CSR is in the interests not just of business, but society more broadly and it introduced a new definition of CSR – “the responsibility of enterprises for their impacts on society, stating that companies should have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy”.<sup>286</sup>

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<sup>279</sup> Clarke, Blanaid - Anker-Sørensen, Linn: The EU as a Potential Norm Creator for Sustainable Corporate Groups in *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 14, p., 202.

<sup>280</sup> Millon, David K.: *Corporate Social Responsibility and Environmental Sustainability in Company Law and Sustainability: Legal Barriers and Opportunities*, Beate Sjøfjell and Benjamin J. Richardson (eds.), Cambridge University Press, 2015, p.52

<sup>281</sup> Clarke, Blanaid - Anker-Sørensen, Linn: The EU as a Potential Norm Creator for Sustainable Corporate Groups in *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 14, pp. 192-193.

<sup>282</sup> Ibid, 190.

<sup>283</sup> Ibid, 191.

<sup>284</sup> Green Paper Promoting a European framework for Corporate Social Responsibility, COM(2001) 366 final, Brussels, 18.7.2001, p.4.

<sup>285</sup> Ibid.

<sup>286</sup> Clarke, Blanaid - Anker-Sørensen, Linn: The EU as a Potential Norm Creator for Sustainable Corporate Groups in *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 14, p. 202.

According to H. Ahlström, CSR is currently a policy area with low political priority.<sup>287</sup> Nevertheless, the CSR strategy's legal interconnectivity shows that there is already a basis for an extended regulatory structure for corporate sustainability in place. This also underlines the continued presence and independence of CSR as a policy area regardless of fluctuations in political will.<sup>288</sup>

It goes without saying that seen as part of the larger institutional framework within which European companies operate, emerging norms of sustainability expressed at the EU level may influence corporations to act responsibly in this area.<sup>289</sup> Among continental European states, there is no widely shared indigenous tradition of shareholder primacy to stand in the way.<sup>290</sup> The only doubt is "whether existing institutional frameworks, which include social norms and traditions in addition to legal rules, establish a context within which significant commitments to ethical CSR seem to be a plausible possibility".<sup>291</sup>

Country-specific institutional variations (for example, with respect to the role of institutional shareholders) make uniform outcomes unlikely.<sup>292</sup> Modern studies provide some preliminary evidence on the occurrence of a 'progressive divide' within the EU: the findings suggest that some Member States generally support, for instance, the sustainable finance agenda such as France, Italy, Netherlands, the Nordics, and to some extent Germany, while other Member States may work towards maintaining the status quo.<sup>293</sup> Even so, especially when compared to the USA and the UK, the traditional continental European commitment to a pluralistic conception of CSR and more recent expressions of concern for sustainability is promising.<sup>294</sup> H. Ahlström claims, that attempts to promote a narrow-minded focus on shareholders' wealth maximization would seem to be a hard sell in this institutional context.<sup>295</sup>

Another doubt to rise here (for instance, referring to the example of how EU has to date adopted the role of a creator of minimum standards in the field of disclosure) is that only large or

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<sup>287</sup> Ahlström, H. Policy Hotspots for Sustainability: Changes in the EU Regulation of Sustainable Business and Finance, *Sustainability* 2019, 11, 499, p.9.

<sup>288</sup> Clarke, Blanaid - Anker-Sørensen, Linn: The EU as a Potential Norm Creator for Sustainable Corporate Groups in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjåfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 14, pp. 192-193.

<sup>289</sup> Millon, David K.: Corporate Social Responsibility and Environmental Sustainability in Company Law and Sustainability: Legal Barriers and Opportunities, Beate Sjåfjell and Benjamin J. Richardson (eds.), Cambridge University Press, 2015, p.52.

<sup>290</sup> Ibid.

<sup>291</sup> Ibid, 53.

<sup>292</sup> Ibid.

<sup>293</sup> Ahlström, H. Policy Hotspots for Sustainability: Changes in the EU Regulation of Sustainable Business and Finance, *Sustainability* 2019, 11, 499, p.14.

<sup>294</sup> Ibid.

<sup>295</sup> Ibid.

listed enterprises are targeted.<sup>296</sup> B. Clarke and L. Anker-Sørensen suggest that nonlisted companies are unlikely to be included in an ambitious sustainability plan. They share hope, however, that the disclosure and governance practices adopted by larger entities will become accepted as best practice and market pressure will lead to their uptake for a larger number of companies.<sup>297</sup>

Another glimpse of hope should be added here. According to the recent 2020 Circular Economy Action Plan's "Key Actions" list crosscutting actions include mainstreaming circular economy objectives in the context of the rules of non-financial reporting, and initiatives on sustainable corporate governance and on environmental accounting in 2020-2021.<sup>298</sup> That might mean that not only large listed companies are targeted.

All in all, it is important for the EU to introduce its progressive policies towards environmental sustainability integration to business by way of a regulation, a binding legislative act rather than a non-binding recommendation, to show a more assertive and intrusive approach to the topic.<sup>299</sup> Whether the various legislative measures are agreed, however, by Member States in the face of competing interests and potentially strong lobbying remains to be seen, and this is perhaps another great challenge.<sup>300</sup>

To sum it up it may be concluded that modern EU company law's core concepts (purpose of company, duties of the board) are remaining neutral to sustainability agenda. However, the EU has a big potential and a serious background regarding possible legislative reform of corporate law. Such a reform can make the latter a reasonable tool for integrating sustainability into the mainstream business practice and there are tendencies to believe that a reform might be initiated on the EU level for Member States to follow. In the last chapter the substance of potential reform will be discussed.

#### **4.1.2. Finland**

In the context of this Master Thesis we are discussing profit-making firms. In this respect the major corporate form in Finland is a limited liability company (osaakeyhtiö in

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<sup>296</sup> Clarke, Blanaid - Anker-Sørensen, Linn: The EU as a Potential Norm Creator for Sustainable Corporate Groups in *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 14, p. 202.

<sup>297</sup> Ibid.

<sup>298</sup> EU Circular Economy Action Plan 2020, p.27.

<sup>299</sup> Ibid.

<sup>300</sup> Ibid.

Finnish)<sup>301</sup> with two company forms, a private company and a public company. Finland has basic statute for both company forms - the Limited Liability Companies Act (Osakeyhtiölaki) of 2006 (Companies Act), which came into force on September 1, 2006.<sup>302</sup>

In Finland under Limited Liability Companies Act the purpose of the company is defined as “to generate profits for the shareholders, unless otherwise provided in the Articles of association”.<sup>303</sup> Although this rule is seen by some Finnish scholars as a manifestation of shareholder primacy, making profit for the shareholders is regarded as the goal of the business of the company from a long-term, overall perspective, and by no means a factor in the making of short-term or individual decisions. Accordingly, the similarity between the Finnish approach and the “enlightened shareholder value” ideology behind the Companies Act is remarkable.<sup>304</sup>

The duties of the management are based on the duty of loyalty and the duty of care.<sup>305</sup> The duty of care is interpreted according to the business judgment rule. The requirement of loyalty extends towards both the company and its shareholders.<sup>306</sup>

#### **4.1.3. Germany**

In Germany, according to Limited Liability Companies Act (Gesetz betreffend die Gesellschaften mit beschränkter Haftung, GmbHG), “a limited liability company may be formed by one person or several persons pursuant to the provisions of this Act for any purpose permitted by law.”<sup>307</sup> The law on public limited companies (Aktiengesetz, AktG), does not explicitly regulate in whose interest German public limited companies are to be run.<sup>308</sup>

The pertinent provision for this issue is section 76 (1) AktG which reads: The management board shall have direct responsibility for the management of the company.<sup>309</sup>

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<sup>301</sup> Mähönen, Jukka T.: Finland. Corporate Governance: Nordic Tradition with American Spices in Comparative Corporate Governance. A Functional and International Analysis, Andreas M. Fleckner, Klaus J. Hopt (eds.), Cambridge University Press, 2013, Chapter 9, p.396.

<sup>302</sup> Ibid, pp.396-397.

<sup>303</sup> Finnish Limited Liability Companies Act (Osakeyhtiölaki), Finnish Legal Gazette No. 624/2006, Chapter 1, Section 5.

<sup>304</sup> Mähönen, Jukka T.: Finland. Corporate Governance: Nordic Tradition with American Spices in Comparative Corporate Governance. A Functional and International Analysis, Andreas M. Fleckner, Klaus J. Hopt (eds.), Cambridge University Press, 2013, Chapter 9, p.397.

<sup>305</sup> Finnish Limited Liability Companies Act (Osakeyhtiölaki), Finnish Legal Gazette No. 624/2006, Chapter 1, Section 1:8.

<sup>306</sup> Mähönen, Jukka T.: Finland. Corporate Governance: Nordic Tradition with American Spices in Comparative Corporate Governance. A Functional and International Analysis, Andreas M. Fleckner, Klaus J. Hopt (eds.), Cambridge University Press, 2013, Chapter 9, p.398.

<sup>307</sup> German Limited Liability Companies Act (Gesetz betreffend die Gesellschaften mit beschränkter Haftung) dated April 20, 1892, German Empire Law Gazette, p. 477 (RBLI. I S. 477) as last amended on July 17, 2017, German Federal Law Gazette I, p. 2446 (BGBI. I S.2446), Chapter 1, Section 1.

<sup>308</sup> German Stock Corporation Act (Aktiengesetz), entered into force on January 1, 1966, German Federal Law Gazette I, p. 1089 (BGBI. I S. 1089).

<sup>309</sup> Ibid, Section 76 (1).

Moreover, section 93 (1) AktG contains a duty of care and responsibility of members of the management board: in conducting business, the members of the management board shall employ the care of a diligent and conscientious manager.<sup>310</sup>

Section 76 plainly says that it is the duty of the members of the management board to manage the company. The section thus differentiates between the competencies of the management board and other parts of the company such as the supervisory board. It is argued that the phrase ‘direct responsibility’ means that the members of the management board would act free from instructions.<sup>311</sup> Therefore, no other party such as a shareholder can instruct the board members as to how they have to make decisions. Thus the management board can make its decision at its own discretion. Presumably, that discretion must be oriented towards the interest of the company (Unternehmensinteresse).<sup>312</sup>

However, the law does not either define the interest of the company or explain in whose interest the company should be run. There are no indications in the AktG how this term is to be understood, and its interpretation is disputed in the academic literature.<sup>313</sup> According to Andreas Rühmkorf, the majority view is that “the term is to be construed according to the stakeholder value concept, which means that the interests of all groups affected by a company (e.g.employees, shareholders, but also creditors and local communities) are to be taken into account by the board in its decisions”.<sup>314</sup>

## **4.2. Corporate Governance Codes. Correlation with Companies Acts**

Those cited provisions of the EU, Finnish and German legislation show that no sustainability dimension is directly addressed in the legal norms defining either purpose of the company or duties of the board.

It is also interesting to look at the provisions of Corporate Governance Codes (no unified Code on the EU level exists). Both companies whose voluntary circular economy standards were studied in the first chapter are listed companies, domiciled in Finland, but also conduct business activities in Germany.

### **4.2.1. Finland**

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<sup>310</sup> Ibid, Section 93 (1).

<sup>311</sup> Rühmkorf, Andreas: Stakeholder value versus Corporate Sustainability in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 17, pp.233-234.

<sup>312</sup> Ibid.

<sup>313</sup> Ibid.

<sup>314</sup> Ibid.

In 2019 the Board of the Finnish Securities Market Association has adopted a new Corporate Governance Code which entered into force on 1 January 2020.<sup>315</sup> The Corporate Governance Code is applicable to all companies that are listed on Nasdaq Helsinki Ltd (Helsinki Stock Exchange). According to the Rules of the Helsinki Stock Exchange, all issuers of shares that are traded on the official list must comply with the Corporate Governance Code.<sup>316</sup>

The analysis of the recent Finnish Corporate Governance Code shows that it does not address sustainability agenda. There is no direct or indirect reference to ‘stakeholders’, ‘CSR’, or sustainability in the Finnish code, which is solely targeted at shareholders. It furthermore uses, when non-legal ‘ownership language’ typical for radical shareholder primacy.<sup>317</sup>

Finnish Corporate Governance Code is one but not the only in the group of other Nordic Corporate Governance Codes and is worth being assessed through the prism of the Nordic Corporate Governance. The latter differs in some respects from the Anglo-Saxon and European Continental models. It is based on national legislation, primarily each country’s companies act, respective accounting acts and acts governing the securities market and securities trading, relevant EU regulation, stock exchange rules and corporate governance codes.<sup>318</sup>

As it evidently comes from the Finnish example Nordic black letter corporate law is neutral to corporate purpose and corporate interest.<sup>319</sup> The Nordic Companies Acts are “manifestations of what David Millon denotes “traditional” shareholder primacy”.<sup>320</sup> The default “purpose” of the company is to generate profits for shareholders.<sup>321</sup> However the latter broadly interpreted as being synonymous with the long-term value of the firm itself, “shareholder’s rights being derivative and secondary”.<sup>322</sup>

Nordic corporate law creates a platform for “shareholder activism”, a platform that is predominantly for the protection of long-term investments, even where the investment’s wider societal purpose is taken into consideration.<sup>323</sup> Therefore, long-termism (opposite to short-termism) has been a trademark of the ‘Nordic model’.<sup>324</sup>

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<sup>315</sup> Finnish Corporate Governance Code 2020. Available at <https://cgfinland.fi/en/corporate-governance-code/> (Accessed 3d March 2020).

<sup>316</sup> Ibid.

Mähönen, Jukka - Johnsen, Guðrún: Law, Culture and Sustainability: Corporate Governance in the Nordic Countries in *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Beate Sjäfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 16, p.223.

<sup>318</sup> Ibid. p.230.

<sup>319</sup> Ibid.

<sup>320</sup> Ibid, p.220.

<sup>321</sup> Ibid.

<sup>322</sup> Ibid, p.221.

<sup>323</sup> Ibid.

<sup>324</sup> Ibid, p.224.

Business-driven legal literature and corporate governance codes are, however, not neutral to corporate purpose and corporate interest.<sup>325</sup> As J. Mähönen points out, “the Nordic codes have been prepared by law firms, stock exchanges, the companies themselves, and institutional investors such as pension funds, without stakeholder participation and reference to real sustainability”.<sup>326</sup>

Nordic traditional shareholder primacy, as set out in the corporate governance codes, resonates also with Bainbridge’s “director primacy” theory of corporate law, which claims that the board’s job is to pursue shareholder wealth, the board possessing the broad discretion to select the means to the end.<sup>327</sup>

Market-driven ‘radical’ shareholder primacy is inspired by Anglo-Saxon corporate governance codes, that make doubtful financial economics based claims about the nature of the privileged position of shareholders within corporations, and legally inaccurate claims of an agency relationship between the board and senior management and the shareholders as ‘owners’ of the company, a claim unknown to Nordic law.<sup>328</sup>

In general, in Nordic countries there is constant search for the optimal model of the company and the related rules and guidelines are continuously updated, preserving the heritage of Nordic Company Law uniformity,<sup>329</sup> but remaining flexible to the rapidly changing modern world realm. The latter dictates its rules. Therefore, modern Nordic approach to the company is not limited only to the traditional perception. It is now expansive to the EU harmonization agenda and the idea of incorporation attractiveness.

However, the distinctiveness of Nordic approach remains: soft shareholder activism, based on a dialogue between investors and the board, gives room for the boards to convince investors of the advantages of being long-term oriented<sup>330</sup> and consider awareness of such goals as sustainability, environment, employment and other societal aspects. Nevertheless, the “shareholder primacy as a social norm, supported by corporate governance codes particular in Sweden and Finland” constitutes the most important barrier to promote sustainability.<sup>331</sup>

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<sup>325</sup> Ibid, p.230.

<sup>326</sup> Ibid.

<sup>327</sup> Ibid, p.221. See also Bainbridge, S. M.: Director Primacy: The Means and Ends of Corporate Governance (2003) 97 Northwestern University Law Review, p. 547.

<sup>328</sup> Ibid, p.222.

<sup>329</sup> Westman, Frederik: Nordic Company Law Regulation and Why Harmonization Through Competition Is Necessary, European Business Organization Law Review 2014, V.15, p. 358.

<sup>330</sup> Mähönen, Jukka - Johnsen, Guðrún: Law, Culture and Sustainability: Corporate Governance in the Nordic Countries in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 16, p. 230.

<sup>331</sup> Ibid, 231.

Being shareholder-friendly Nordic company law strengthens the role of active shareholders, but does not set a clear direction for their activism.<sup>332</sup> Therefore there is a call for corporate law reform to push companies to pursue sustainable value a competitive advantage taking into account such strong sides of the Nordic countries' corporate law as its flexibility, commitment of the important private long-term investors and the sustainability concerns of public market actors.<sup>333</sup>

#### **4.2.2. Germany**

In Germany the Corporate Governance Code in the version dated 16 December 2019 entered into force on 20 March 2020.<sup>334</sup> The Code highlights the obligation of Management Boards and Supervisory Boards – in line with the principles of the social market economy – to take into account the interests of the shareholders, the enterprise's workforce and the other groups related to the enterprise (stakeholders) to ensure the continued existence of the enterprise and its sustainable value creation (the enterprise's best interests). These principles not only require compliance with the law, but also ethically sound and responsible behaviour (the "reputable businessperson" concept, Leitbild des Ehrbaren Kaufmanns).<sup>335</sup>

With their actions, the company and its governing bodies must be aware of the enterprise's role in the community and its responsibility vis-à-vis society. Social and environmental factors influence the enterprise's success. In the enterprise's best interests, Management Board and Supervisory Board ensure that the potential impact of these factors on corporate strategy and operating decisions is identified and addressed.<sup>336</sup>

The Management Board is responsible for managing the enterprise in its own best interests.<sup>337</sup> This responsibility has a status of principle in the recent Code edition. However, in comparison with the previous Code edition this provision has been shaped as follows.

Previously the Code explicitly stipulated that the management board took into account the interest not only of the shareholders of the corporation but also of its employees and other

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<sup>332</sup> Ibid.

<sup>333</sup> Sjäfjell, Beate - Mähönen, Jukka T.: Upgrading the Nordic Corporate Governance Model for Sustainable Companies, *European Company Law*, 2014, Volume 11, Issue 2, 58.

<sup>334</sup> German Corporate Governance Code 2020. Available at: [https://dcgk.de/files/dcgk/usercontent/en/download/code/191216\\_German\\_Corporate\\_Governance\\_Code.pdf](https://dcgk.de/files/dcgk/usercontent/en/download/code/191216_German_Corporate_Governance_Code.pdf) (Accessed 5<sup>th</sup> April 2020); See also Press Release on (German Corporate Governance Code 2020). Available at <https://dcgk.de/files/dcgk/usercontent/en/download/pressrelease/200320%20PM%20Code%202020.pdf> (Accessed 15<sup>th</sup> April 2020).

<sup>335</sup> German corporate Governance Code, Foreword, p.2.

<sup>336</sup> Ibid.

<sup>337</sup> Ibid, Management and supervision I, Governance tasks of the Management Board, Principle 1.



stakeholders.<sup>338</sup> The 2017 Corporate Governance Code edition defined the tasks of the management board in the following way in provision 4.1.1: “The Management Board assumes full responsibility for managing the company in the best interests of the company, meaning that it considers the needs of the shareholders, the employees and other stakeholders, with the objective of sustainable value creation”.<sup>339</sup>

This definition of the interest of the enterprise in the Code was significant as it reinforced the majority view that board members should consider not only the interests of shareholders, but also those of the employees and the general public.<sup>340</sup> This provision in the previous edition of the German Code was neither a recommendation nor a suggestion. The Code contained ‘recommendations’ (indicated by the word ‘shall’) and suggestions (indicated by the word ‘should’) whilst the remaining passages of the Code were considered to be descriptions of statutory requirements and explanations.<sup>341</sup> This meant that the Code provision 4.1.1 about the interest of the company, with its pluralistic definition of interest of the company, was intended to be a description of a statutory requirement.<sup>342</sup>

According to A. Rühmkorf, there was an argument therefore that the legislator had to intervene and add a clarification into the AktG, following the model of Code provision 4.1.1 in the German Corporate Governance Code. Such an amendment would represent the majority view in the academic literature and prevent an increasing shareholder value-based interpretation of the interest of the company.<sup>343</sup> The phrase ‘sustainable value creation’ appeared only in Code provision 4.1.1 and was not mentioned in section 76 AktG. At first glance, the use of the word ‘sustainable’ suggests an opportunity for the board to promote sustainable development. However, the academic commentary to the Code suggests a less optimistic reading.<sup>344</sup>

Germany is commonly referred to as a ‘stakeholder value system’, which places it in opposition to systems that reflect the idea of shareholder primacy.<sup>345</sup> This characterization suggests that German company law and corporate governance could provide more scope for the

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<sup>338</sup> Merkt, Hanno: Germany. International and External Corporate Governance in Comparative Corporate Governance. A Functional and International Analysis, Andreas M. Fleckner, Klaus J. Hopt (eds.), Cambridge University Press, 2013, Chapter 12, p. 537.

<sup>339</sup> German Corporate Governance Code 2017, p.5. Available at [https://www.dcgk.de/files/dcgk/usercontent/en/download/code/170214\\_Code.pdf](https://www.dcgk.de/files/dcgk/usercontent/en/download/code/170214_Code.pdf) (Accessed 3d May 2020).

<sup>340</sup> Rühmkorf, Andreas: Stakeholder value versus Corporate Sustainability in The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 17, p. 235.

<sup>341</sup> Ibid.

<sup>342</sup> Ibid.

<sup>343</sup> Ibid, pp. 235-236.

<sup>344</sup> Ibid.

<sup>345</sup> Ibid, p.232.

promotion of corporate sustainability in its three dimensions of environmental, social and economic sustainability than other systems.<sup>346</sup>

However, as H. Merkt points out whilst this pluralistic understanding of the meaning of the ‘interest of the company’ in German AktG is still widely held today, it is not undisputed. Since the 1990s, there has been an increasing influence of the idea of shareholder value in Germany due to the opening of the German capital markets. Further development and internationalization of capital markets, upheld shareholder orientation making it increasingly popular among listed corporations.<sup>347</sup>

Also, in the German academic debate there is a growing tendency to give the interests of shareholders (moderate) priority over those of other stakeholders, though the practical differences of the proposed approach and the traditional stakeholder value perspective are negligible.<sup>348</sup> In contrast, the objective of the previous edition of the Corporate Governance Code was to strengthen stakeholder interests in order to meet “public criticism of capitalism”.<sup>349</sup> Moreover, there has been very limited case law on the question of how to interpret the interest of the company.<sup>350</sup>

In this context, ‘sustainable’ should be interpreted by having recourse to the various groups of stakeholders affected by the company (e.g. shareholders, employees, creditors, suppliers, the public) as those different groups would only be willing to continue their contribution to the company if the company provides attractive incentives. It is seen as a rejection of the shareholder value approach.<sup>351</sup> This line of interpretation further strengthens the pluralistic understanding of the interest of the company, but it does not provide any opportunities for the promotion of the different dimensions of corporate sustainability.<sup>352</sup>

In summary, the above-mentioned shows that a pluralistic understanding of the interest of the company prevails in the German academic literature. According to this view, board members do not have to prioritise the interests of shareholders in their decisions, but they have to weigh the interests of the different groups affected by the company.<sup>353</sup>

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<sup>346</sup> Ibid, p.232.

<sup>347</sup> Merkt, Hanno: Germany. International and External Corporate Governance in Comparative Corporate Governance. A Functional and International Analysis, Andreas M. Fleckner, Klaus J. Hopt (eds.), Cambridge University Press, 2013, Chapter 12, p. 537.

<sup>348</sup> Ibid.

<sup>349</sup> Ibid.

<sup>350</sup> Rühmkorf, Andreas: Stakeholder value versus Corporate Sustainability in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 17, p.234-235.

<sup>351</sup> Ibid, p. 236.

<sup>352</sup> Ibid.

<sup>353</sup> Ibid.

However, it is hard to disagree with A. Rühmkorf, who notes that the abstract term ‘interest of the company’ must be concretised in individual decisions. There is no guideline as to how the interests of the different groups affected by the company have to be taken into account by board members and which interest they should prioritise in a particular case. It is therefore down to the board members to decide to what extent they use their discretion for the promotion of sustainable development.<sup>354</sup>

Therefore, the practical effect for corporate sustainability is probably a defensive one. Minimally, boards are not allowed to consistently prioritise shareholder value and to make it the sole goal of their decisions.<sup>355</sup> They may use their discretion to promote goals of sustainable development even if this means that the returns to shareholders are lower. The board members do not have to justify such a move with business reasons.<sup>356</sup> This means that whilst there is no duty to promote sustainable development, board members at least do not violate their duties when they seek to do so. The limitation to all of this is the overriding duty to ensure the long-term profitability of the company. When balancing the interests of employees, the public and shareholders, boards must in any case pursue the long-term profitability of the corporation.<sup>357</sup>

Nevertheless, at closer inspection, “it is doubtful to what extent German company law and corporate governance really promote corporate sustainability”.<sup>358</sup> In this area of the law, “sustainability seems to be more rhetoric than reality”.<sup>359</sup> Legislative intervention is needed in order to overcome the limited scope that currently exists for the promotion of sustainable development.<sup>360</sup>

A. Rühmkorf makes a conclusion that ‘the vagueness of the current law does not do much to encourage board members to pursue the different dimensions of sustainability in their decisions’.<sup>361</sup> The legislator should therefore also take a step further and include ‘sustainable value creation’ with a content that resonates with the grand challenges of our time.<sup>362</sup>

To sum it up, when it comes to the German jurisdiction context it also may be found that in practice “pluralistic understanding” of the purpose of the company is more like a guiding principle, but not a duty that can be “enforced by various stakeholder groups such as employees or local communities”.<sup>363</sup> There is an increasing tendency to interpret the interest of the company

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<sup>354</sup> Ibid.

<sup>355</sup> Ibid.

<sup>356</sup> Ibid.

<sup>357</sup> Ibid.

<sup>358</sup> Ibid, p.244.

<sup>359</sup> Ibid.

<sup>360</sup> Ibid.

<sup>361</sup> Ibid, p.245.

<sup>362</sup> Ibid.

<sup>363</sup> Ibid, p.244.

in a more shareholder value-oriented way.<sup>364</sup> While the German Corporate Governance Code has clarified the pluralistic understanding of the purpose of the company, the binding company laws remain silent.<sup>365</sup> The latter questions the legislator's continuing willingness to understand companies as having duties to a broader range of stakeholders than just shareholders.<sup>366</sup>

### **4.3. Conclusion**

In this chapter we examined the basics of the EU, German and Finnish company law: purpose of the company and duties of the board. The conclusion was made that company law on all the discussed levels provides no legal infrastructure for decision-making in companies and the role and duties of levels of decision-making regarding sustainability.<sup>367</sup> It does not directly narrow the purpose of the company and the duties of the board to the interests of creation value for shareholders, but remains too neutral, silent about the sustainability agenda and societal welfare. The latter creates a vacuum to be occupied by the shareholder primacy social norm that is very strong throughout the jurisdictions and will be discussed further.

With the example of Germany that is known for its pluralistic view towards the interest of the company we discovered that in fact this assumption is not undisputable and even in this jurisdiction the power of shareholder primacy social norm should not be underestimated. The Finnish example (within the Nordic Corporate law model) was also very instructive, showing how shareholder primacy social norm remains a serious barrier for promoting sustainability. In Finland the company law strengthens the role of active shareholders but does not set a clear direction for their activism.

## **5. COMPANY LAW REFORM**

We have previously discussed possible ways of addressing circular economy agenda for business: compliance with circular economy law, volunteerism. We identified that company law in its recent state-of-the-art is neutral to sustainability agenda.

In this chapter we will present and discuss latest academia findings related to sustainability agenda in company law and its potential regarding shift to sustainability and

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<sup>364</sup> Ibid.

<sup>365</sup> Ibid.

<sup>366</sup> Ibid.

<sup>367</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, *International and Comparative Corporate Law Journal*, 13 (2019) 3, p. 48.

circular economy. Keeping in mind findings of the previous chapter we will figure out what should be changed in company law to enhance circular economy. We will provide an example of proposals for EU company law legislation amendments - SMART project.

## **5.1. Shareholder Primacy and the Problem of Externalisation**

### **5.1.1. Shareholder Primacy Social Norm**

Sustainability as an overarching goal is supported on a high-level: governments have entered into far-reaching international agreements for sustainability, in the form of SDGs and the Paris Agreement on climate change. In accordance with the high-level goals and targets business activity is fundamental to sustainability.<sup>368</sup>

At the EU level, as we mentioned above the EU Treaties clearly show that sustainable development is the pervasive objective and is meant to be the guiding principle of the EU's policies and activities. The Treaty on the European Union (TEU) emphasizes the position of sustainable development, in Europe and globally.<sup>369</sup> The significance of business and finance contributing to the overarching goal of sustainability, environmentally, socially and economically, is recognized. Moreover, business and investors are also increasingly signing up to this recognition<sup>370</sup> calling in B.J. Richardson's words for "long-term investing and patient "slow money", and so too its fiduciary law framework that implies preservation and enhancement of capital value over time".<sup>371</sup>

However, fundamental role of business in creating the value necessary for sustainable development is also contradicted by the fact that business plays major role in creating unsustainable social and environmental impacts.<sup>372</sup> At the same time, business is challenged by the necessity "to transform the demand for sustainable development into an opportunity, to create and access new markets, and to innovate responses that will satisfy traditional industry

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<sup>368</sup> Ibid, p. 40.

<sup>369</sup> Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union. Official Journal of the European Union 26 October 2012, C 326P. 0001 – 0390.

<sup>370</sup> Sjøfjell, Beate: Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking in Preventing Environmental Damage from Products: An Analysis of the Policy and Regulatory Framework in Europe, Eléonore Maitre-Ekern, Carl Dalhammar and Hans Christian Bugge (eds.), Cambridge University Press 2018, Chapter 5, p.123.

<sup>371</sup> Richardson, Benjamin J.: Aligning Social Investing with Nature's Timescales in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 40, p.566.

<sup>372</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, International and Comparative Corporate Law Journal, 13 (2019) 3, p. 41.

demands and new societal demands for sustainable development”.<sup>373</sup> More to that, the existing system of corporate regulation, governance and control does not deliver sustainable economic activity.<sup>374</sup>

To sum it up, the high targets are set, the role of business is defined, but the real path for action is far from being clear enough. We believe that the difficulties surrounding the process of making the latter path clearer should be analyzed in a more comprehensive way than merely stating that the existing law should be changed. It is indispensable to find effective solutions taking into consideration that there are also other constraints to be considered, including social norms, market and architecture (constraints imposed by physical world).

From the above analysis of the EU, German and Finnish company law provisions we see that although company law does not actively promote sustainability it nevertheless does not exclude it as an option for companies. However, still there is a big influence of shareholder primacy as a social norm. In the context of this research it is important to define to what extent and how shareholder primacy social norm represents a barrier towards sustainability for companies.

B. Sjøfjell and M. B. Taylor have come to conclusion that comparative company law research makes clear that a combination of partly open, partly silent and partly tentative law has allowed the strong social norm of shareholder primacy to occupy the vacuum created by what company law does not explicitly state about societal welfare and to ensure that companies externalize social and environmental impacts.<sup>375</sup> On the examples from Finland and Germany discussed above we have clearly seen that when companies’ acts remain silent or neutral about the purpose of the company or duties of the board the shareholder primacy social norm is likely to take this space.

Together company law legislation (neutral or silent), social norms and market incentives, facilitated by architecture of global financial markets, have combined to shape the mainstream legal myth that shareholder primacy is embedded in company law and drive corporate practice on a manner that externalizes responsibility for negative environmental, social and economic impacts.<sup>376</sup>

According to B. Sjøfjell, in theory, company law does not exclude sustainability or related social norms from the purpose of the corporation. However, in practice, mainstream

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<sup>373</sup> Leal Filho, Walter – Pociovălișteanu, Diana Mihaela - Borges de Brito, Paulo Roberto - Borges de Lima, Ismar: Towards a Sustainable Bioeconomy: Principles, Challenges and Perspectives, Springer International Publishing, 2018, p.511.

<sup>374</sup> Sjøfjell, Beate: Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking, p.123.

<sup>375</sup> Sjøfjell, Beate - Taylor, Mark B: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p. 65.

<sup>376</sup> Ibid.

understanding of the purpose of the corporation has come to be dominated by shareholder primacy social norm that has excluded most other norms.<sup>377</sup> This norm is related to the notion of viewing the corporation as the shareholders' property, or as a 'nexus of contracts' in which the shareholders need to receive the main protection, a norm that does not seem to follow from company law.<sup>378</sup> As a result, the hegemony of shareholder primacy within company law excluded social and environmental concerns from corporate decision-making.<sup>379</sup> It is worth examining the sited point of view in more details.

The shareholding company or corporation as a legal form, "is said to be one of humanity's most ingenious legal inventions".<sup>380</sup> This corporation form allows investors (shareholders) to receive returns from their investment, while being shielded from the financial risks associated with this venture. On the other hand, investors do not have access to share capital and do not have many options of how to recoup their investments: they can do it either through dividends or by selling their shares. Therefore one can argue for a presumed need to protect shareholders as investors because the latter need protection per se and in part to encourage potential shareholders to invest.<sup>381</sup> However, this argument is not an absolute truth.

In this respect B. Sjøfjell and M. B. Taylor fairly claim that "the marriage of the corporate form and the principle of limited liability may seem obvious to us today but it is a historically contingent form of organization that has evolved to serve societal ends".<sup>382</sup> Society has gradually accepted and promoted this business form on the assumption that in pursuing its self-interest in profit the company contributes to an overarching goal of society - increasing societal welfare, especially in terms of value and job creation as part of overall economic development.<sup>383</sup>

For most of the twentieth century, large public companies followed a philosophy called managerial capitalism. In managerial companies boards of directors operated largely as self-selecting and autonomous decision-making bodies, with dispersed shareholders playing a passive role.<sup>384</sup> Directors viewed themselves not as shareholders' servants, but as trustees for great institutions that should serve not only shareholders but other corporate stakeholders as well, including customers, creditors, employees, and the community.<sup>385</sup> Equity investors were treated

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<sup>377</sup> Ibid.

<sup>378</sup> Ahlström, H. Policy Hotspots for Sustainability: Changes in the EU Regulation of Sustainable Business and Finance, *Sustainability* 2019, 11, 499, p.14.

<sup>379</sup> Sjøfjell, Beate - Taylor, Mark B: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p. 65.

<sup>380</sup> Ibid, p. 45.

<sup>381</sup> Ibid, p. 46.

<sup>382</sup> Ibid.

<sup>383</sup> Sjøfjell, Beate - Taylor, Mark B: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p. 47.

<sup>384</sup> Stout, Lynn A.:The Shareholder Value Myth. Cornell Law Faculty Publications, 2013, Paper 771.

<sup>385</sup> Ibid.

as an important corporate constituency, but not the only constituency that mattered and share price was not assumed to be the best proxy for corporate performance.<sup>386</sup>

If we look even more retrospectively, many corporations formed in the late eighteenth and early nineteenth centuries were created specifically to develop large commercial ventures like roads, canals, railroads, and banks.<sup>387</sup> In those corporations investors were usually also customers, who's major concern and interest was to make sure the business would provide good service at a reasonable price – not to maximize investment returns.<sup>388</sup>

Since 1970s, the idea that the corporation contributes to societal welfare via profit-driven value creation has to a great extent been replaced by Anglo-American, law-and-economic theories arguing in the words of M. Friedman that because shareholders “own” the corporation, the only “social responsibility of business is to increase its profits”.<sup>389</sup> In a very influential article titled the “Theory of the Firm” M.C. Jensen and W.H. Meckling claimed that a key problem in corporations was getting wayward directors and executives to focus on maximizing the wealth of the corporations’ shareholders.<sup>390</sup>

Due to the interaction of company law and the shareholder primacy norm the general understanding of the corporate purpose has been narrowed radically. The company was defined first, as the shareholders’ property and later as a “nexus of contracts” in which concentrating on the maximization of returns for shareholders is viewed as rational, efficient, way of achieving the broader societal good.<sup>391</sup>

To illustrate the mainstream company law understanding of the shareholder primacy, we can address R. Kraakman and H. Hansmann who early in the year 2000, claimed that “academic, business, and governmental elites,” shared a consensus “that ultimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; ...and the market value of the publicly traded corporation’s shares is the principal measure of the shareholders’ interests.”<sup>392</sup> What’s more, Hansmann and Kraakman asserted, this “standard shareholder-oriented model” not only dominated U.S. discussions of corporate purpose, but

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<sup>386</sup> Ibid.

<sup>387</sup> Hansmann, Henry - Pargendler, Mariana: The Evolution of Shareholder Voting Rights: Separation of Ownership and Consumption, Yale Law Journal, Vol. 123, 2014, p.103.

<sup>388</sup> Ibid.

<sup>389</sup> Friedman, Milton: The Social Responsibility of Business Is to Increase Its Profits, New York Times Sunday Magazine, September 13, 1970, pp. 33-32 and 122-26.

<sup>390</sup> Jensen, Michael C. - Meckling, William H.: Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 Journal of Financial Economics 305 (1976).

<sup>391</sup> Sjäfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p. 47-49.

<sup>392</sup> Hansmann, Henry - Kraakman, Reinier H.: The End of History for Corporate Law, 2000-2001, 89 Georgetown Law Journal pp. 440-441.



conversations abroad as well. In their words, “the triumph of the shareholder-oriented model of the corporation is now assured” not only in the U.S., but in the rest of the civilized world.<sup>393</sup>

Thus overall societal purpose of incorporation was replaced by the objective of profit for shareholders.<sup>394</sup> The narrowing of the perceived scope of corporate purpose, which arises from the dominance of the shareholder primacy norm, means that “boards, and by extension managers, tend to be unwilling to recognize and integrate to their decisions the financial risks inherent in environmental and social harms”.<sup>395</sup> Today this tendency is seen in treating, climate change, for instance, as an environmental ‘externality’, not as a material determinant of corporate wealth, or failing to consider climate change impacts due to ignorance or unreflective assumption, paralysis caused by the inherent uncertainty of its magnitude and timing, or a default to a base set by regulators or industry peers.<sup>396</sup>

Within mainstream law-and-economics contributions the idea that the corporate form was originally established with a general and multifaceted purpose of advancing social welfare has been reduced to a simple argument that prioritization of shareholder interests would result in the achievement of that welfare.<sup>397</sup> However, as B. Sjøfjell and M. B. Taylor point out the social justification of this purpose of the corporation under which pursuing maximum returns for shareholders will result in aggregate social welfare, is often overlooked.<sup>398</sup> The negative externalities generated by unsustainable business activity, are also overlooked since the latter are not automatically compensated nor present obstacles to maximization of returns for shareholders.<sup>399</sup>

As Sjøfjell and Taylor point out, “when shareholders’ interests are understood as dictating focus on short-term maximization of returns the appropriate balance with respect to social and environmental externalities is difficult to achieve even for those company decision-makers that wish to try”.<sup>400</sup> It is of paramount importance to understand clearly that shareholder primacy social norm, not law affects largely modern managers’ decisions and therefore, constitutes the major barrier to sustainability narrative.

L. A. Stout concludes that contrary to popular belief, the managers of public companies have no enforceable legal duty to maximize shareholder value. Certainly they can choose to maximize profits; but they can also choose to pursue any other objective that is not unlawful,

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<sup>393</sup> Ibid, p. 468.

<sup>394</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.49.

<sup>395</sup> Ibid.

<sup>396</sup> Barker, Sarah: 'Directors' Personal Liability for Corporate Inaction on Climate Change, Governance Directions, February 2015, p.21.

<sup>397</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p. 48.

<sup>398</sup> Ibid.

<sup>399</sup> Ibid.

<sup>400</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.49.

including taking care of employees and suppliers, pleasing customers, benefiting the community and the broader society, and preserving and protecting the corporate entity itself. Shareholder primacy is a managerial choice – not a legal requirement.<sup>401</sup>

In general, as it is claimed by M. B. Taylor and M. van der Velden common traditional business models are management economics concepts such as efficiency (the ratio of the actual output to the potential output) and productivity (narrowly defined as rate of output per unit input) and shareholder primacy (maximizing short-term returns to shareholders).<sup>402</sup> Those tend to be socially normative with respect to decision making by the managers of firms: they form the basic logic of managerial interactions with suppliers (i.e., cutting costs, ensuring quality) and consumers (i.e., setting prices, developing brand loyalty) and form the basis for meeting the targets expectations in terms of shareholders primacy, i.e., maximizing returns to shareholders.<sup>403</sup> Consequently, the drive for efficiency and productivity is normative in that it is presumed to be a good thing for business by the community of managers, owners, and shareholders, among others.<sup>404</sup>

It is worth mentioning here that, the assumption that a market will correct companies who remain indifferent to environmental and social standards is a misleading: for instance, the idea that consumer concern about the climate or labour standards will affect decisions by company board members is overestimated.<sup>405</sup> The dominance of shareholder primacy in the minds of board members and shareholders indicates that “market corrections will only function when the market imposes costs that are, in their judgement, higher than the benefit of short term profit made possible by externalizing the costs of social and environmental impacts”.<sup>406</sup> The capital markets function to funnel and exacerbate the shareholder primacy drive, supported by securities regulation and stock exchange rules that have as their primary aim to protect investors, not the various other interest affected by corporate activity.<sup>407</sup>

Hence, Sjøfjell and Taylor fairly point out, that the mainstream corporate governance emphasis on the narrow agency relationship between shareholders and corporate boards and managers, including in corporate groups, reinforces the idea that company law is irrelevant to all but the economic result of the companies themselves.<sup>408</sup>

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<sup>401</sup> Stout, Lynn A.: The Shareholder Value Myth. Cornell Law Faculty Publications, 2013, Paper 771.

<sup>402</sup> Taylor, M.B. - van der Velden, M.: Resistance to Regulation: Failing Sustainability in Product Lifecycles, Sustainability 2019, 11, 6526, p.8.

<sup>403</sup> Ibid.

<sup>404</sup> Ibid.

<sup>405</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.50.

<sup>406</sup> Ibid.

<sup>407</sup> Cullen, Jay and Mähönen, Jukka: Taming Unsustainable Finance: the Perils of Modern Risk Management in the Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Beate Sjøfjell and Christopher M. Bruner (eds.), Cambridge University Press 2020, Chapter 8; pp. 100-113.

<sup>408</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.51.

To sum it up, comparative law analyses makes it possible to bring the argument that social norms have played a key role in shaping the understanding of corporate purpose and, in the process, limiting the scope of the law in practice.<sup>409</sup> The social norm of shareholder primacy has come to dominate in the interpretative space allowed by company law.<sup>410</sup>

### **5.1.2. Traditional Responses to Sustainability: SCR and Sectoral Legislation**

Self-regulation based on Corporate Social Responsibility (CSR), corporate stewardship codes, or market regulation based on non-financial reporting constitute traditional approaches to encouraging corporate sustainability.<sup>411</sup> There is also national level environmental regulation for companies to comply with. The latter is often contested by powerful actors and is fragmented across different sectors,<sup>412</sup> which can be used by business actors to choose among different levels of obligation, thereby starting a race-to-the-bottom within and across industry sectors.<sup>413</sup>

In the previous chapters we discovered the limitations of both volunteerism and circular economy law. In case of company law the latter interacts with social norms such as shareholder primacy and sustainability.<sup>414</sup> As it was shown previously, the dominance of shareholder primacy norm in the definition of corporate purpose represents a fundamental obstacle to corporate sustainability.<sup>415</sup> Hence, one of the major goals of company law is to place the legal purpose of the corporation on a more sustainable footing.<sup>416</sup>

Before coming to a conclusion what to change in company law to enhance circular economy it is beneficial to identify how governments can use their legislative or regulatory powers to ensure business operates on the basis of sustainable models of value creation.<sup>417</sup> In this respect, one should keep in mind that regulatory power of law interacts with the regulatory power of markets, social norms and material constraints.<sup>418</sup>

Regulation involves measures to constrain or shape behavior usually implemented in law, understood as legal rules.<sup>419</sup> Legal rules may draw their regulatory power (or lack thereof) from non-legal sources, such as an economic or social sanction or incentive.<sup>420</sup> Social norms and

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<sup>409</sup> Ibid.

<sup>410</sup> Ibid.

<sup>411</sup> Sjøfjell, Beate - Taylor, Mark B: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p. 41.

<sup>412</sup> Ibid.

<sup>413</sup> Biermann, F. - Pattberg, P. - van Asselt, H. – Zelli, F.: The Fragmentation of Global Governance Architectures: a Framework for Analysis. *Global Environ Politics* 9(4):14–40, p.29

<sup>414</sup> Sjøfjell, Beate - Taylor, Mark B: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p. 42.

<sup>415</sup> Ibid.

<sup>416</sup> Ibid.

<sup>417</sup> Lessig, Lawrence: *Code, and Other Laws of Cyberspace*, New York, 1999.

<sup>418</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose p. 41.

<sup>419</sup> Ibid, p. 42.

<sup>420</sup> Ibid.

markets either promote respect for a rule or encourage non-compliance.<sup>421</sup> B. Sjøfjell and M. B. Taylor claim the act of respecting a rule is the result of a complex set of power relationships.<sup>422</sup>

Based on the regulatory theory developed by Lessig, who's work on the regulation of cyberspace argues that regulation in cyberspace may be perfectly achieved through modifications to software codes, foreshadowing the possibility that "law as a code is the start to the perfect technology of justice,"<sup>423</sup> the concept of regulatory ecology is used to understand the ways in which law, markets, social norms, and architecture (the material for physical constraints imposed on a subject of regulation) interact to create or sustain particular hotspots.<sup>424</sup> Modalities of constrain enable to ask questions about the ways the respect for a rule or non-compliance are encouraged.<sup>425</sup>

Regulatory ecology approach requires that we think about social norms, market and material constraints aspects not as discrete phenomena to be regulated by law, but as factors constraining or enabling the effectiveness of law.<sup>426</sup> By putting these elements together in a system of interactions, it becomes clear that no one constraint can be said to be the single cause of the effectiveness (or otherwise) of the law, but it is the cumulative effect of all of these constraints, as well as the interactions between them, which help create an ecology of regulation: they reinforce or undermine the effectiveness of a rule creating a regulatory ecology around a social phenomenon.<sup>427</sup>

Thinking about regulation as a system or an ecology allows for consideration of the complexity of factors, both legal and non-legal, which go into generating respect for a rule.<sup>428</sup> Therefore, the basic claim to be made here is that state is only one regulator, others such as markets and communities also exert influence.<sup>429</sup> This polycentric approach helps to take into consideration not only regulation as such, but three other non-legal dimensions as well.

First are social norms that constitute normative constraints imposed not through the organized or centralized actions of a state, but through the many slight and sometimes forceful

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<sup>421</sup> Ibid.

<sup>422</sup> Ibid, p. 43.

<sup>423</sup> Morgan, Bronwen – Yeung, Karen: *An Introduction to Law and Regulation: Text and Materials*. Cambridge University Press, 2007, p.102. For Lessig law may not only continue to regulate behavior in cyberspace through ordinary laws that apply to behavior in the physical world (through the laws of copyright, defamation and so forth), although its effectiveness will vary depending upon the characteristics of cyberspace, but it may also regulate through the control of code itself, or the institutions (i.e. coders) who produce the code that shapes the contours of cyberspace. To discover difference between command-competition-consensus-communication-code regulatory instruments see Morgan, Bronwen – Yeung, Karen: *An Introduction to Law and Regulation: Text and Materials*. Cambridge University Press, 2007 (pp.80-113).

<sup>424</sup> Taylor, M.B. - van der Velden, M.: *Resistance to Regulation: Failing Sustainability in Product Lifecycles*, *Sustainability* 2019, 11, 6526, p.3.

<sup>425</sup> Ibid.

<sup>426</sup> Ibid, p.4.

<sup>427</sup> Ibid.

<sup>428</sup> Sjøfjell, Beate - Taylor, Mark B: *Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose*, p. 43.

<sup>429</sup> Ibid.

sanctions that members of a community impose on each other.<sup>430</sup> Like the sanction of law the sanction of social norms is imposed after the fact (ex post) but, unlike law, social norms are “imposed by community not state”.<sup>431</sup>

Second - market as a regulatory modality. It constrains imposed by, for example, price, costs and risk, not least with respect to the principle factors of production, such as capital, labour, natural resource commodities.<sup>432</sup> Where payment for a benefit or resource can be deferred or where risk is the potential for financial loss in the future the constraining obligation involved in a market activity or taken on and remains as long as remains in the market.<sup>433</sup>

Final category of constraint, or modality of regulation –architecture.<sup>434</sup> Natural occurring phenomena, for example, the location of natural resources, or human-built physical constraints, including communications technology inventions which allows for the movement of capital across borders, shares to be traded in micro-seconds or which transform labour contracts<sup>435</sup> Unlike law or social norms, one often cannot choose to ignore a material constraint and pay the cost later, although one will always have interpretive flexibility as to how to respond to architecture, for example by changing methods of obtaining key factor inputs.<sup>436</sup>

Markets and architecture tend to constrain immediately, while law and social norms sanction after the fact.<sup>437</sup> It is important to find a way in which law can be made more effective in the sense of generating respect for a rule, in particular rules which seek to ensure sustainability.<sup>438</sup>

When the law attempts to constrain through deterrence alone, and ignores the combined forces of markets, social norms and the material nature of the product or service, it is unlikely to be very effective.<sup>439</sup> The regulations that work are those which leverage the power of the other modes of regulation in the service of law.<sup>440</sup> Indeed, “to operate efficient policies which seek to change people’s behavior, government needs adequate information first about how they should behave-that is, what standard or target it should set; secondly, about how they are behaving now,

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<sup>430</sup> Ibid.

<sup>431</sup> Ibid.

<sup>432</sup> Ibid.

<sup>433</sup> Ibid.

<sup>434</sup> Ibid.

<sup>435</sup> Ibid, p. 44.

<sup>436</sup> Ibid.

<sup>437</sup> Taylor, M.B. - van der Velden, M.: Resistance to Regulation: Failing Sustainability in Product Lifecycles, Sustainability 2019, 11, 6526, p.4.

<sup>438</sup> Sjøfjell, Beate - Taylor, Mark B: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p. 45.

<sup>439</sup> Ibid.

<sup>440</sup> Ibid.

and why; and thirdly, about what sanctions or incentives will align their behavior with the desired standard or target. Getting any of these answers wrong is liable to vitiate the policy”.<sup>441</sup>

According to B. Sjøfjell and M. B. Taylor, “law is most effective when it is designed to leverage the regulatory power of other modes of regulation: markets, social norms and architecture”.<sup>442</sup> If law makers get it wrong such interventions may be ignored or make for law that is ineffective or even that works counterproductively to its own aims.<sup>443</sup>

Responses to the social and environmental externalities generated by companies tend to fall along a continuum between state regulation and self-regulation.<sup>444</sup> State regulation takes the form of laws and regulations, for example, environmental law. Business self-regulation usually termed CSR, usually covers the same substantive terrain, such as environment, but seeks to promote action by the companies themselves.<sup>445</sup>

It is suggested that the international CSR movement has had a role in maintaining the status quo in corporate practices as it has inadvertently reinforced shareholder primacy.<sup>446</sup> The agenda does not offer the tools to encourage corporations to transform their business models because CSR is separated from corporate governance. Consequently, the agenda has played a role in systematically narrowing down corporate purpose, and it has given little room to engender real corporate sustainability practices.<sup>447</sup> Hence, whereas the CSR has been a useful agenda, it is still a ‘business-as-usual’ action agenda for weak sustainability.<sup>448</sup>

CSR has arisen, in part, as a response to the regulatory failings built into the globalized economic system.<sup>449</sup> The challenges facing CSR is that it is by definition a form of weak regulation, that is self-regulation with no enforcement mechanisms.<sup>450</sup> Even reporting requirements set in law remain left to voluntary and discretionary measures, leading to risks of corporate capture, lack of comparability, lack of consistency and uncertainty in benchmarking.<sup>451</sup>

CSR may be seen as an attempt to elaborate a socially normative idea that companies should do more than merely maximize profit, but it is entirely at the mercy of the shareholder

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<sup>441</sup> Morgan, Bronwen – Yeung, Karen: *An Introduction to Law and Regulation: Text and Materials*. Cambridge University Press, 2007, p. 85.

<sup>442</sup> Sjøfjell, Beate - Taylor, Mark B: *Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose*, p. 45.

<sup>443</sup> Ibid.

<sup>444</sup> Sjøfjell, Beate - Taylor, Mark B: *Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose* p.54

<sup>445</sup> Ibid.

<sup>446</sup> Ahlström, H. *Policy Hotspots for Sustainability: Changes in the EU Regulation of Sustainable Business and Finance*, *Sustainability* 2019, 11, 499, p.16.

<sup>447</sup> Ibid.

<sup>448</sup> Ibid.

<sup>449</sup> Sjøfjell, Beate - Taylor, Mark B: *Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose*, p.55.

<sup>450</sup> Ibid.

<sup>451</sup> Villiers, Charlotte Louise - Mähönen, Jukka T.: *Accounting, Auditing and Reporting: Supporting or Obstructing the Sustainable Companies Objective?* in *Company Law and Sustainability: Legal Barriers and Opportunities*, Beate Sjøfjell and Benjamin J. Richardson (eds.), Cambridge University Press, 2015.

primacy drive, with its strong influence on company decision-making.<sup>452</sup> It is purely voluntary exercise, the sanction for any violation of the social norms often will be at most expressed in the reputational effect.<sup>453</sup>

To sum it up, neither of these two traditional approaches – CSR and environmental law – takes into account the challenges posed by the regulatory ecology of corporate purpose, in which shareholder primacy is the dominant norm.<sup>454</sup> The latter places legal compliance with social and environmental standards in a tension with perceived legal obligations under company law (in the minds of board members, managers and shareholders).<sup>455</sup> Therefore transition of business towards sustainable circular economy is not possible only through mere compliance with circular economy law and application of CSR practices. Company law should play a major role here. However, there is a need of company law reform taking into account comprehensive regulatory ecology approach considering all factors constraining or enabling the effectiveness of law with the aim not to underestimate the existing power of shareholder primacy social norm.

### **5.1.3. Internalizing Externalities**

This Master Thesis main societal challenge to tackle is the way circular economy can be enhanced with the help of law, the ability of the latter to ensure sustainable shift to circular economy for business. In the second and third chapters we overviewed circular economy and presented voluntary standards of companies. It was concluded that the power of both to enhance circular economy is limited, neither volunteering or circular economy law can suit as the only and optimal solutions. As it was found in the previous subchapter both approaches do not take into account strong dominance of shareholder primacy social norm that affects decision-making in companies. The identified drawbacks of the company law are: neutrality towards sustainability agenda and strongly related to it - powerful shareholder primacy social norm. Both contribute to the negative externalizing of sustainability aspects from the core of company's decision-making process. Therefore it is worth investigating the potential changes in company law that can help to *internalize* environmental *externalities* of products.

Economists define *externalities* as the external costs of an exchange in a market or “market failures”, imperfections in the market to be cured by regulation through adopting

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<sup>452</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.55.

<sup>453</sup> Ibid, p.56.

<sup>454</sup> Ibid, p.54.

<sup>455</sup> Ibid.

corrective measures,<sup>456</sup> effect of a transaction on those not participating in it (third parties).<sup>457</sup> External costs related to a product exist when the product creates negative environmental consequences, when produced, transported, in use or when it is disposed of, which neither the manufacturer, nor the seller, nor the user is required or feels obligated to take into account.<sup>458</sup>

In the typical atmospheric pollution situation, large numbers (including possibly future generations) compete with the polluter for use of environment, and, given the very high aggregate of their avoidance costs, abatement of the pollution will usually be the cheaper solution.<sup>459</sup> Externality may give rise to a misallocation but the administrative and other costs of correcting it may outweigh the social benefits arising from such action.<sup>460</sup>

As we discovered in chapter dedicated to circular economy law the life cycle thinking is reflected in the Circular Economy Package of the EU, and constitutes an alternative to traditional base of economy - the linear business model. It is also an alternative to the fragmentation of the product life cycle into the smaller spheres of responsibility of the numerous individual businesses that typically populate global value chains.<sup>461</sup>

Indeed, finding out how to internalize environmental, social, and economic impacts of corporate activity is one of the most pressing and pervasive issues of our time.<sup>462</sup> Sjøfjell uses *internalizing* in the strong sense, meaning that the environmental consequences are to be integrated along the whole life cycle of the product – from the design and to the recycling or disposal of the product. Internalization in the strong sense entails that products are designed, produced, transported, used, recycled, and/or disposed of in a way that the negative environmental consequences are mitigated as much as possible.<sup>463</sup>

Sjøfjell points out that the internalization should be based on scientific ground and emphasizes that “the dire status as regards the convergence of environmental crises facing global society is encapsulated in the concept of ‘planetary boundaries’, which was first identified in the

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<sup>456</sup> Morgan, Bronwen – Yeung, Karen: *An Introduction to Law and Regulation: Text and Materials*. Cambridge University Press, 2007, p.18.

<sup>457</sup> Vinuales, Jorge E.: *Sustainable Development in International Law* in the Oxford Handbook of International Environmental Law, L. Rajamani, J. Peel (eds.), Oxford University Press, 2nd edn. 2019, p.22

<sup>458</sup> Sjøfjell, Beate: *Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking*, p.101.

<sup>459</sup> Morgan, Bronwen – Yeung, Karen: *An Introduction to Law and Regulation: Text and Materials*. Cambridge University Press, 2007, p.23

<sup>460</sup> Ibid.

<sup>461</sup> Heiskanen, E.: *The Institutional Logic of Life Cycle Thinking*. *Journal of Cleaner Production*, Vol. 10, No. 5, 2002, pp. 427-437.

<sup>462</sup> Sjøfjell, Beate: *Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking*, p.102.

<sup>463</sup> Ibid.



ground breaking article by J. Rockström et al. in 2009,<sup>464</sup> and updated and re-affirmed by Steffen et al. in 2015”.<sup>465</sup> Sjøfjell also relies on K. Raworth’s concept: “achieving a safe and *just* operating space for humanity”.<sup>466</sup>

The concept of planetary boundaries sets the framework within which a discussion of internalizing environmental externalities should take place. ‘Greener’, or more environmentally friendly, products, are not sufficient – there is a need to reduce the environmental impacts enough to stay within planetary boundaries.<sup>467</sup>

As we have discovered earlier the reductionist approach of the Chicago School of law and economics has served to promote the detrimental social norm of shareholder primacy, where the primary – even the only – goal of corporations is to maximize returns for shareholders.<sup>468</sup> It was concluded that the influence of these ideas and the legal myths they have contributed to creating: corporations as the property of shareholders and profit maximization as the legal duty of boards are very strong.<sup>469</sup>

Agency theory, in the dominant but rather limited and overly shareholder-focused variant, lends support to the social norm of shareholder primacy, which encourages the *externalization* of environmental and social impacts.<sup>470</sup> As it was discovered earlier, shareholder primacy constitutes a main barrier to corporate sustainability.

Beate Sjøfjell cites the modern mainstream version of agency theory presented in the highly influential book by Kraakman et al., *The Anatomy of Corporate Law*.<sup>471</sup> In their introduction, the authors set out a broad goal for corporate law (as opposed to what they denote as the immediate *function* of corporate law, ‘of defining a form of enterprise and containing the conflicts among the participants in this enterprise’) “the overall objective of corporate law – as of any branch of law – is presumably to serve the interests of society as a whole.”<sup>472</sup> More particularly, the appropriate goal of corporate law is to advance the aggregate welfare of all who are affected by a firm’s activities, including the firm’s shareholders, employees, suppliers, and

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<sup>464</sup> Rockström, J. - Steffen, W. - Noone, K. - Persson, Å. - Chapin, F.S. - III; Lambin, E. - Lenton, T.M. - Scheffer, M. - Folke, C. - Schellnhuber, H. - et al: Planetary boundaries: Exploring the safe operating space for humanity, *Ecology and Society*, 2009, 14, 32.

<sup>465</sup> Steffen, Will – Richardson, Katherine - Rockström, Johan - Cornell, Sarah - Fetzer, Ingo - Bennett, Elena - Biggs, Reinette - Carpenter, Stephen - Vries, Wim et al: Planetary Boundaries: Guiding Human Development on a Changing Planet, *Science* 2015, 347.

<sup>466</sup> Raworth, K.: *Doughnut Economics: Seven Ways to Think Like a 21st-Century Economist*; Chelsea Green Publishing: White River Junction, VT, USA, 2017.

<sup>467</sup> Sjøfjell, Beate: Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking, p.103.

<sup>468</sup> Ibid, p.104.

<sup>469</sup> Ibid.

<sup>470</sup> Ibid.

<sup>471</sup> Kraakman, Reinier et al: *The Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford University Press, 2017.

<sup>472</sup> Ibid.

customers, as well as third parties such as local communities and beneficiaries of the natural environment. This is what economists would characterize as the pursuit of overall social welfare”.<sup>473</sup>

In Sjøfjell’s view, Kraakman et al. are also in their 2017 edition still overly restricted to the shareholders.<sup>474</sup> When the authors eventually get to ‘external constituents’, they recognize the detrimental impact corporations may have, when ‘left unchecked’: ‘environmental degradation, violations of human rights, anticompetitive behaviour, or practices that pose systemic risk to the economy’.<sup>475</sup> They also recognize that ‘limited liability – an essential feature of the corporate form – serves to compound the problem, by permitting shareholders to bear only a fraction of the costs their companies’ activities cause for third parties’. Nevertheless, the authors remain sceptical to what they see as a ‘recent trend toward employing the legal strategies of corporate law to tackle broad social problems’.<sup>476</sup>

The social norm of shareholder primacy, which mainstream agency theory supports, has a detrimental impact on the environment, on people, on the businesses themselves, and on shareholders that have a long-term perspective with their investment. It appears to be perceived as a beneficial instrumental goal: by maximizing returns for shareholders, ‘social welfare’ will indirectly be maximized.<sup>477</sup>

This idea, however, is a legal myth: boards are not the agents of shareholders; they are the stewards of the corporation, with a legal duty to protect and promote the interests of the corporation<sup>478</sup> and the law does not require corporate managers to maximize shareholder value, this is just something managers can opt to do.<sup>479</sup>

As it was previously highlighted, across jurisdictions, corporate law does not set out a duty to maximize the returns to shareholders.<sup>480</sup> It is shareholder primacy drive that narrows the scope of the considerations of the boards and shortens their time perspective. With the perceived

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<sup>473</sup> Armour, J. - Hansmann, H. - Kraakman, R. - Pargendler, M.: *What Is Corporate Law? Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford University Press, 2017, pp. 23–24.

<sup>474</sup> Sjøfjell, Beate: *Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking*, p.109.

<sup>475</sup> Ibid, also acknowledged by Enriques, L. et al: *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, *Anatomy of Corporate Law: A Comparative and Functional Approach* in Kraakman, Reinier et al: *The Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford University Press, 2017, p. 93.

<sup>476</sup> Ibid.

<sup>477</sup> Armour, J. - Hansmann, H. - Kraakman, R. - Pargendler, M.: *What Is Corporate Law? Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford University Press, 2017, pp. 23–24.

<sup>478</sup> Sjøfjell, Beate: *Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking*, p.111.

<sup>479</sup> Stout, Lynn A.: *The Shareholder Value Myth*. Cornell Law Faculty Publications, 2013, Paper 771.

<sup>480</sup> Sjøfjell, Beate: *Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking*, p.111.

duty of maximization of returns for shareholders, any environmental impact that is not enforceably regulated as the corporation's responsibility is ignored.<sup>481</sup>

Therefore, as Sjøfjell points out, one of the core agency issues, which is the largest and most important shift in focus from the mainstream use of agency theory in corporate law, is the agency issue between the corporate decision-makers as agents, and people and the environment directly affected by the business of the corporation as principals.<sup>482</sup> We remember from above mentioned that, in Kraakman et al., the impact of corporate activity on people that do not have a legally recognized relationship with the corporation and the environment is not discussed as an agency issue but defined rather as a question of *externalities*.<sup>483</sup> Such interests 'extraneous to' the corporation should in their view normally be considered and protected through other areas of law.<sup>484</sup>

However, how to internalize the environmental and social impacts of business into corporate decision-making, or in other words, how to ensure that corporate decision-makers act thoughtfully and appropriately as agents for people and the environment the corporation impacts as principals, is arguably the most pervasive and crucial issue of modern corporate law.<sup>485</sup>

This enquiry will not therefore take as its starting point that environmental concerns must be protected by environmental law, or that a corporation in country A cannot be held responsible for impacts in country B, or that broadening the scope of interests to be considered is impinging on 'property rights' of shareholders.<sup>486</sup> It should open up the debate to a more comprehensive discussion of how environmental externalities as a corporate law agency problem, can be handled.<sup>487</sup>

The most important here is that identifying these issues relevant to the corporation should be a central part of the corporate decision-makers' responsibility.<sup>488</sup> It is another way of asking how each corporation can find out how to contribute to meeting the grand challenge of our time: securing the social foundation for people everywhere now and in the future while staying within planetary boundaries.<sup>489</sup>

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<sup>481</sup> Ibid, p.112.

<sup>482</sup> Ibid, p.115.

<sup>483</sup> Ibid.

<sup>484</sup> Enriques, L. et al: The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies', *Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford University Press, 2017, p. 93.

<sup>485</sup> Sjøfjell, Beate: Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking, p.115.

<sup>486</sup> Ibid, p.116.

<sup>487</sup> Ibid.

<sup>488</sup> Ibid.

<sup>489</sup> Ibid.

Operationalizing planetary boundaries on the level of a sector, or a line of products, is one of the important research questions of our time.<sup>490</sup> To be successful will require finding out how to operationalize and integrate planetary boundaries into corporate and financial business models. This is that of “the firm itself – including, particularly, its owners’ vs. contractual parties”.<sup>491</sup>

Operationalizing this broader and life cycle-based approach to agency issues in corporate law, arguably requires both legislative reform and changes in corporate culture. Through legislative reform, life cycle thinking can be included in the duties of the corporate board, barriers to corporate sustainability can be removed, and drivers can be strengthened.<sup>492</sup> The narrow focus on what the purpose of the corporation is, limits the possibility to change corporate behaviour and there is therefore a need to include regulation and governance of business decision-making in the toolbox for sustainability. It is not something that prevails over all economic activity, but it is an important aspect to consider for enabling sustainable corporate behavior.<sup>493</sup>

According to H. Ahlström, in order to safeguard Earth’s life-support system on which the welfare of current and future generations depends, changes in the economic realm are necessary.<sup>494</sup> However, to ensure sustainable development, there is not only a need to re-think how the economic playing field is structured, but also the regulatory system that governs it. Business and financial market law reforms are increasingly seen as key for scaling up sustainability.<sup>495</sup>

More to that, the care for future generations should not be treated as something ephemeral, it is undoubtedly based on the reality that environmental degradation is sometimes final or extraordinarily expensive to repair.<sup>496</sup> Therefore, to a large degree, nowadays and future regulation should be produced by a belief in obligations owed by the present to future generations. Current practices may produce losses that might be acceptable if no one else were affected, but that are intolerable in light of their consequences for those who follow.<sup>497</sup>

## **5.2. SMART Project: Company Law Reform Proposal**

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<sup>490</sup> Ibid.

<sup>491</sup> Ibid.

<sup>492</sup> Sjäfjell, Beate: Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking, p.121.

<sup>493</sup> Ahlström, H. Policy Hotspots for Sustainability: Changes in the EU Regulation of Sustainable Business and Finance. Sustainability 2019, 11, 499, p.2.

<sup>494</sup> Ibid, p.1.

<sup>495</sup> Ibid.

<sup>496</sup> Morgan, Bronwen – Yeung, Karen: An Introduction to Law and Regulation: Text and Materials. Cambridge University Press, 2007, p.35.

<sup>497</sup> Ibid.

Legal norms can change both: social and moral norms. One of the core findings of previous subchapter, citing B. Sjøfjell, is that “thoughtful and research-based corporate law reform can shape and promote corporate culture that is based on life cycle thinking and life cycle management”.<sup>498</sup> Undoubtedly, other legislative reforms, including shaping circular economy law are also needed, but a corporate law reform is arguably key.<sup>499</sup>

“By introducing life cycle thinking in the corporate boards of European lead companies, reforming corporate culture from within, the fragmentation of responsibility and accountability across the global value chains could be mitigated”.<sup>500</sup> Such legislative reform “could draw on the most appropriate of the voluntary guidelines, standards, and certification schemes available, and contribute to a level playing field where the front runners are rewarded for their efforts”.<sup>501</sup>

The latter would bring a shift from the current regulatory approach, where environmental concerns predominantly are protected through environmental law, including, for instance, the limited regulatory tools of circular economy law. To be environmentally sustainable, a circular economy must operate within planetary boundaries<sup>502</sup> and to achieve this, the actual social costs of products must be internalized into business.<sup>503</sup>

A way forward may be to tap into the sustainability drive of thought-leaders in business and finance, through smart regulation that promotes a change of corporate culture by integrating product life cycle thinking and life cycle management in lead European corporations.<sup>504</sup> Instead of top-down regulation, integrating product life cycle thinking into the role and duties of the corporate board can realize the potential of each corporation to, in its own innovative and creative way, find out how to design, produce, market, sell, repair and recycle products in an environmentally sustainable way.<sup>505</sup> It will give start for the transformation of corporate business models from the unsustainable and linear to the sustainable and circular.<sup>506</sup>

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<sup>498</sup> Sjøfjell, Beate: Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking, p.122.

<sup>499</sup> Sjøfjell, B. – Wiesbrock, A. (eds): The Greening of European Business under EU Law: Taking Article 11 TFEU Seriously, Abingdon, UK: Routledge, 2015.

<sup>500</sup> Sjøfjell, Beate: Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking, p.122. See also Heiskanen, E.: The Institutional Logic of Life Cycle Thinking. *Journal of Cleaner Production*, Vol. 10, No. 5, 2002, pp. 427-437.

<sup>501</sup> Ibid.

<sup>502</sup> In line with the goal of Environment Action Programme to 2020, Decision No 1386/ 2013/EU of 20 November 2013 on a General Union Environment Action Programme to 2020, Living well, within the limits of our planet, OJ L 354 (28December 2013), pp. 171–200.

<sup>503</sup> Sjøfjell, Beate: Redefining Agency Theory to Internalize Environmental Product Externalities. A Tentative Proposal Based on Life-Cycle Thinking, p.123.

<sup>504</sup> Ibid.

<sup>505</sup> Ibid.

<sup>506</sup> Ibid, p.124.

Those companies that seek to internalize the negative externalities of their business, appear still to be solitary front-runners comparing to mainstream business.<sup>507</sup> Therefore, the reform of company law is a necessary intervention in order to create regulatory ecology that will keep companies from making decisive steps towards sustainability<sup>508</sup> and contribute to scaling it up from front-runners to the mainstream economic players. To achieve this company law needs to be based on normative foundation of sustainability, and with that starting redefine a corporate purpose and duties of the board.<sup>509</sup>

The term “sustainability” lacks a concrete legal content, however, UN SDGs to which EU completely adhered to<sup>510</sup> appear best to refer to.<sup>511</sup> Adoption of SDGs gave a new impetus of production and consumption that urgently must be placed on a socially and environmentally sustainable footing, which a matter of international consensus.<sup>512</sup> Shcholars have been working hard to translate this emerging consensus into frameworks that can be applied to policymaking.<sup>513</sup> In the context of this thesis and possible company law reform we suppose that the reasonable option to define sustainability with the reference to the SDGs is the one adopted the planetary boundaries and social foundations framework as sustainability framework.<sup>514</sup>

This sustainability framework is consistent with the SDGs. However, while the SDGs are policy targets intended to harmonise goals for states, the planetary boundaries framework presents research-based limits for human impacts on our planet’s biosphere.<sup>515</sup> Consequently, this framework does not distinguish between states or between economic sectors, but aggregates impacts on the planet and on human society as one system.<sup>516</sup> This makes the framework well suited to considering the sustainability of product lifecycles, which are often the result of transactions between different business entities across multiple jurisdictions.<sup>517</sup>

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<sup>507</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.60.

<sup>508</sup> Ibid.

<sup>509</sup> Ibid.

<sup>510</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions “Next steps for a sustainable future. European action for sustainability”, COM (2016) 739, Strasbourg, 22.11.2016.

<sup>511</sup> Krämer, Ludwig: Sustainable Management of Natural Resources in Sustainable Management of Natural Resources. Legal Instruments and Approaches, Helle Tegner Anker and Birgitte Egelund Olsen (eds.), Cambridge-Antwerp-Portland, Intersentia, 2018, Chapter 2, p. 20.

<sup>512</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.60.

<sup>513</sup> Ibid.

<sup>514</sup> Taylor, M.B. - van der Velden, M.: Resistance to Regulation: Failing Sustainability in Product Lifecycles, Sustainability 2019, 11, 6526, p.2.

<sup>515</sup> Ibid.

<sup>516</sup> Ibid.

<sup>517</sup> Ibid.

In this respect we can go back to the mentioned above J. Rockström et al<sup>518</sup> and K. Raworth<sup>519</sup> who pooled knowledge of different Earth system processes to inform the world about the space for sustainable action within “planetary boundaries”.<sup>520</sup> K. Raworth focuses on the social and economic foundations which underpin human development and combat social and economic deprivation such as those formulated at the SDGs.<sup>521</sup> She formulated the grand challenge of our time: “achieving a safe and just operating space for humanity – securing the social foundation for humanity now and in the future while staying within planetary boundaries”.<sup>522</sup>

The latter should not be underestimated because as it was already concluded: “human production and consumption is breaching at least four of currently identified planetary boundaries: climate change, biosphere integrity, land system change, and biogeochemical cycles (phosphorus and nitrogen)”.<sup>523</sup>

Drawing on this research-based understanding of sustainability – reform proposals have been made within the SMART project by B.Sjåfjell, J. Mähönen, T. Novitz, C. Gammage, H. Alhström et al to support and strengthen the EU transition to sustainability.<sup>524</sup> The proposals are presented in three reports dedicated to Business, Finance and Products and are interconnected. The proposals concerning business are prerequisites for the proposals concerning finance and products, and, in turn, proposals concerning finance and products may act as enforcers and drivers for the timely and successful implementation of the changes suggested in the way business operates.<sup>525</sup>

The report dedicated to business titled “Securing the future of European business: SMART reform proposals” (her and after SMART report on Business) presents potential negative impacts of continued unsustainable economic behaviour on business and finance,

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<sup>518</sup> Steffen, Will – Richardson, Katherine - Rockström, Johan - Cornell, Sarah - Fetzer, Ingo - Bennett, Elena - Biggs, Reinette - Carpenter, Stephen - Vries, Wim et al: Planetary Boundaries: Guiding Human Development on a Changing Planet. Science 2015, 347.

<sup>519</sup> Raworth, K.: Doughnut Economics: Seven Ways to Think Like a 21st-Century Economist; Chelsea Green Publishing: White River Junction, VT, USA, 2017.

<sup>520</sup> Sjåfjell, Beate - Taylor, Mark B: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.60.

<sup>521</sup> Ibid.

<sup>522</sup> Raworth, K.: Doughnut Economics: Seven Ways to Think Like a 21st-Century Economist; Chelsea Green Publishing: White River Junction, VT, USA, 2017.

<sup>523</sup> Sjåfjell, Beate - Taylor, Mark B: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.61.

<sup>524</sup> Sjåfjell, B. - Mähönen, J. - Novitz, T. - Gammage, C. - Ahlström, H.: Securing the future of European business: SMART reform proposals, SMART Report (2020), available at SSRN: <https://ssrn.com/abstract=3595048>; Maitre-Ekern, E. - Taylor, M. B. - van der Velden, M.: Towards a Sustainable Circular Economy. SMART Reform Proposals, SMART Report (2020), available at SSRN: <https://ssrn.com/abstract=3588232>; Cullen J. - Mähönen, J. - Rapp Nilsen, H.: Financing the transition to sustainability: SMART reform proposals, SMART Report (2020), available at SSRN: <https://ssrn.com/abstract=3594433>. More about SMART Project see <https://www.smart.uio.no/> (Accessed 20th May 2020).

<sup>525</sup> Sjåfjell, B. - Mähönen, J. - Novitz, T. - Gammage, C. - Ahlström, H.: Securing the future of European business: SMART reform proposals, SMART Report (2020), p.4.

outlines the connections between the EU's role as a global actor in trade and investment, and European business activities across global value chains, presents the EU law framework for the proposals, discusses important elements of the reform proposals, presents the proposals themselves, including notably for the key issues of redefining the purpose of the company and the duties of the board, concrete proposals for changes in the EU legislative framework.<sup>526</sup>

Under the SMART report on Business, core barriers to achieving sustainability are defined as follows:

- the externalization by business of its negative environmental, social, economic governance impacts, with fragmentation of enterprises across corporate groups, networks and global value chains;
- the entrenched economic beliefs supporting the pressure for short-term maximisation of returns;
- still persistent belief in the self-correcting ability of fully-informed markets;
- lack of relevant, reliable and verified information on sustainability impacts of business, which undermines the potential of a number of sustainability-oriented initiatives.<sup>527</sup>

It is concluded that company law reform is needed, for the sake of securing the future of European business, to give them a level playing field and legal certainty – and to ensure the contribution of business to sustainability.<sup>528</sup>

At the center of the reform proposal is a draft proposal of an amendment of the Company Law Directive 2017, Title I, to add the redefinition of the purpose of the undertaking and duties of the board.<sup>529</sup> The proposal to redefine the purpose of the undertaking does not take away profit as an intrinsic element of the nature of business or of their value creation nor changes the differences between various forms of undertakings in the European economy, and how profit is used and distributed in them.<sup>530</sup> The distinction between for-profit and not-for-profit is not challenged, nor is it proposed to make all businesses become social enterprises.<sup>531</sup>

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<sup>526</sup> Ibid, p.12.

<sup>527</sup> Ibid, p.11.

<sup>528</sup> Ibid.

<sup>529</sup> The term 'undertaking' is used to broaden the scope from 'company' and broadening of the scope of the Company Law Directive is suggested accordingly, to include any type of undertaking with limited liability. The undertakings applicable in every Member State should be listed in a new Annex IIB of the Company Law Directive. Annex IIB should include all the entities listed in present Annex IIB and all other entities with limited liability in every Member State, such as all cooperative forms. See Sjøfjell, B. - Mähönen, J. - Novitz, T. - Gammage, C. - Ahlström, H.: Securing the future of European business: SMART reform proposals, SMART Report (2020), pp.58-63.

<sup>530</sup> Ibid, p.57.

<sup>531</sup> Ibid.



What is proposed is to position the value creation of European, with profit as an intrinsic element, within the context of the transition to sustainability that we need to undertake.<sup>532</sup>

It is assumed that European business is struggling with trying to be a part of the transition to sustainability, within a system that appears to value short-term maximization of returns above all else.<sup>533</sup> This entails trying to create value in a sustainable way, while maximization of returns is perceived by many as the overarching purpose, due to the shareholder primacy drive. Instead, SMART report on Business propose that sustainable value creation within planetary boundaries is set as the overarching purpose, outlining the scope within which profit will continue to be made.<sup>534</sup>

Concept of sustainable value requires that the various interests for value creation and profit be negotiated within the confines of environmental, social and economic sustainability.<sup>535</sup>

The reform proposal seeks to create the foundation for companies to internalize externalities which would involve a life-cycle based approach to value creation.<sup>536</sup> Reform proposal includes sustainability as an element of the definition of corporate purpose.<sup>537</sup> The notion of sustainability as defined by certain identifiable, physical boundaries and foundations is specifically designed to address the practice of externalizing social and environmental impacts, in the interest of maximizing profit.<sup>538</sup>

The project seeks to displace the shareholder primacy norm from its hold over the interpretation of corporate purpose and replace it with a qualification of value creation by the social-material norm of sustainability.<sup>539</sup> By placing boundaries on value creation in law, the intention is to ensure those externalities are internalized by companies.<sup>540</sup>

### 5.3. Conclusion

In this chapter we examined the basics of the EU, German and Finnish company law: purpose of the company and duties of the board. The conclusion was made that company law provides no legal infrastructure for decision-making in companies and the role and duties of the board regarding sustainability.<sup>541</sup> It does not directly narrow the purpose of the company and the duties of the board to the interests of creation value for shareholders, but remains too neutral,

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<sup>532</sup> Ibid.

<sup>533</sup> Ibid.

<sup>534</sup> Ibid.

<sup>535</sup> Sjøfjell, Beate - Taylor, Mark B.: Clash of Norms: Shareholder Primacy vs. Sustainable Corporate Purpose, p.63.

<sup>536</sup> Ibid.

<sup>537</sup> Ibid.

<sup>538</sup> Ibid.

<sup>539</sup> Ibid, p.64.

<sup>540</sup> Ibid.

<sup>541</sup> Ibid, p.48.

silent about the sustainability agenda and societal welfare. The latter creates a vacuum to be occupied by the shareholder primacy social norm that is very strong throughout the jurisdictions.

With the example of Germany that is known for its pluralistic view towards the interest of the company we discovered that in fact this assumption is not undisputable and even in this jurisdiction the power of shareholder primacy social norm should not be underestimated. The Finnish example (within the Nordic Corporate law model) was also very instructive, showing how shareholder primacy social norm remains a serious barrier for promoting sustainability. In Finland the company law strengthens the role of active shareholders but does not set a clear direction for their activism.

We then presented the theoretical basis regarding the shareholder primacy social norm, its roots and nowadays levers. Traditional responses to sustainability agenda (CSR, sectoral regulation) and their downsides were discussed in short. Altogether with the findings of two first chapters it brought us to the point that neither voluntary standards of the companies or sectoral law (environmental, circular economy law) can solely ensure sustainable shift to circular economy for business because both do not take into consideration the great power of shareholder primacy social norm and its influence - the pattern to externalize the sustainability risks (and environmental, circular economy in particular).

Therefore, the principal challenge was defined as to find ways to intervene in the existing regulatory ecology (combination of four modalities: law, social norms, market and architecture) so that companies internalize the environmental, social and economic externalities, and contribute to “a safe and just operating space for humanity”.<sup>542</sup> We provided an example of company law reform proposal – SMART project.

The conclusion was made that the company law must take back the power of defining the purpose of the company and the role and duties of the board.<sup>543</sup> Without putting company law on a normative foundation of sustainability, defined scientifically as planetary boundaries and social foundations, the drive for the maximization of returns to shareholders will continue to be the decisive element in corporate decision-making.<sup>544</sup> The latter would always externalize environmental, circular economy agenda for companies and constitute a crucial stumbling block to enhance circular economy.

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<sup>542</sup> Ibid, p.66.

<sup>543</sup> Ibid.

<sup>544</sup> Ibid.

## 6. CONCLUSION

To answer the research question, we examined voluntary standards of two companies: UPM and Stora Enso, those related to circular economy and with waste prevention, management focus. Current circular economy and company laws were overviewed with the same focus to find out to what extent law compliments, supports and ensures voluntary standards, what are the major stumbling blocks to overcome.

In the second chapter we addressed the major EU policy making documents: EU Circular Economy Action Plan 2015 and Monitoring Framework that highlighted the importance of shift to circular economy and the role of business. We focused on the waste prevention and management aspects. Then turned to the main lever for the mentioned policies – EU Waste Framework Directive and its obligation towards Members States to develop and monitor Waste Prevention Plans.

German and Finnish Waste Prevention Plan's general issues and the role they give to the business were examined. The conclusion was made that both states are more likely to learn from business and apply advice and support tactics, preferring to use companies' voluntary initiatives as an example or object for further studies when it comes to develop the waste prevention policies. It was interesting to find out that Member States at question do not guide and command precisely the industry with the instruments of top-down approach. Both Member States tend to implement more flexible and stakeholder-oriented approach relying on a strategic dialog with companies. In the context of this research an important issue noticed in the policies is the willingness of states to promote new approaches and forms of cooperation between the enterprises that gives special light to the problem of supply chain limitation of voluntary standards we depicted in the third chapter.

We also looked at the core concepts of the WFD: waste, disposal, end-of-waste status, precautionary principle through the prism of the CJEU interpretation available in the recent cases. It gave an opportunity to conclude that the level of harmonization regarding interpretation of these concepts on the EU level is still much to be improved and Member States have a wide margin of discretion regarding waste hierarchy and certain rules regarding establishment of end-of-waste status. The latter is mostly to be assessed and decided by national administrative bodies or courts on a case-by-case basis. This brings too high level of uncertainty for business and most probably is associated by the companies with high time and financial costs risks. The more

harmonized interpretation and implementation of end-of-waste rules across the EU must be enabled to further facilitate the use of recovered material.<sup>545</sup>

In the third chapter voluntary standards of two companies UPM and Stora Enso towards shift to circular economy and its waste prevention and management dimension were the objects of examination. The latter made it possible to conclude that companies have high ambition, want to be on driver's seat and show example to peers. Companies pay close attention towards circular economy agenda, reporting constantly and profoundly on the matter. Companies set Zero Waste target, contribute to SDG 12, promote going beyond compliance with law through the supply chain. In general, despite the fact companies use different language to describe their voluntary standards of waste prevention and management the latter are still similar and follow the same logic in both: substantive and procedural dimension (enforcement and monitoring). However, the studied material also clearly shows that due to the lack of common standards in law, companies refer to diversity of voluntary standards offered by international sustainability-related initiatives and, therefore, the possible voluntary assurance techniques might differ much as well.

To support companies we should not underestimate the possible drawbacks of volunteerism: diversity of standards companies are referring to (even two companies analysis shows the diversity of global voluntary initiatives they are contributing to); lack of external audit (assurance, "only limited assurance can be given",<sup>546</sup> "lack of means for comparison over time and among companies"<sup>547</sup>); supply chain limitation (while set values and targets are promoted and ensured within the value chain through such tools as Codes of Conduct; demand (when companies change their contract role to being suppliers themselves) and finance chains are not involved); lack of remedies, enforceability mechanisms (as voluntary commitments are not by their nature binding and do not have power of law).

In the fourth chapter company law was analyzed (cornerstone issues: purpose of companies and duties of board on the levels of EU, Germany and Finland). One of the core concerns of the chapter was that company law remains too neutral to sustainability.

In the fifth chapter we found out that company law's implementation and real business life compliance is largely affected by strong shareholder primacy social norm. It brings to externalization of environmental and circular economy agenda from the core decision-making in companies. That should be changed the other way: externalities to be internalized. We discussed

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<sup>545</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Implementation of the Circular Economy Package: Options to Address the Interference Between Chemical, Product and Waste Legislation, COM (2018) 32 final, Strasbourg, 16.1.2018, p.5.

<sup>546</sup> Fagerström, Arne - Cunningham, Gary: Accounting and Auditing of Sustainability. Sustainable Indicator Accounting. SIA, 2016, p. 45.

<sup>547</sup> Ibid.

a possible company law reform on the EU level and provided an example of such a reform proposal within the SMART project.

To sum it up, based on the research results it can be concluded that voluntary standards and traditional form of approach towards circular economy aspects through environmental or in particular through circular economy law are not only and solely enough to ensure sustainable shift of business towards circular economy.

Company law has a major role here but not in the up-to-date state of the arts. It should be changed mostly through redefining the purpose of the company and the duties of the board, so as circular economy agenda externalized today due to the sound influence of shareholder primacy social norm would be internalized to the core of companies decision making process and ensure the life-cycled based approach to value creation. Putting company law on a normative foundation of sustainability will help to deal with such problems as “free riding”, “greenwashing”, “SDG washing” and will create a level playing field.

All in all, possible regulation role when we speak about circular economy might be a combination of volunteerism and command. Relationship between data surveyed in the thesis gives a ground to suggest that we might give the volunteerism the first floor but shape law (and company law in the first place) so as it is able to induce to volunteer and provide due mechanisms to ensure that commitments are taken seriously.<sup>548</sup> The latter might be an issue for further research.

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<sup>548</sup> Holley, Cameron – Gunnigham, Neil: Natural Resources, New Governance and Legal Regulation: When Does Collaboration Work? New Zealand Universities Law Review, June 2011, Vol. 24, p.333.

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